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READINGS
IN MARKETING

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FIRST EDITION
THIRD IMPRESSION

New York Toronto London
McGRAW-HILL BOOK COMPANY, INC.
1949

READINGS IN MARKETING

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PREFACE

This book of marketing readings has been definitely planned to accompany and supplement the case book *Problems in Marketing.* Teaching experience indicates that students who are approaching marketing for the first time have a real need for background material which will not only provide some factual information but which will also, and more importantly, furnish a setting and perspective for the study of cases and a stimulus to thought and imagination.

It is our conviction that these purposes can be more effectively served by a selection of readings than by a conventional marketing text. We believe that the selection here presented affords both wider range and deeper penetration than it would be possible to achieve in a textbook of normal length. The obvious disadvantage, that a selection of readings does not present a connected framework of thought, does not seem serious to us in the light of our conviction that one of the chief virtues of the case method is that it forces students to think for themselves rather than passively to accept some allegedly authoritative framework of thought.

The readings in this volume have been organized into sections which correspond broadly to the principal sections in the case book, and the reader is referred to the introduction to that book for a statement of the authors' reasons for the order of the sections. Broadly speaking, the approach in each book is from the standpoint of the business functions of marketing.

For permission to reproduce the materials appearing in this volume we are obligated to numerous authors and publishers, especially the *Harvard Business Review*, *The Journal of Marketing*, and various governmental sources. To a number of our colleagues, including particularly Professors Neil H. Borden, Milton P. Brown, Kenneth S. Harris, Howard T. Lewis, Charles A. Livesey, Sterling J. Livingston, and Harry R. Tosdal, we are indebted both for suggestions of material and for editorial assistance. The preparation of the manuscript was the work of Mrs. Ruth C. Hetherston and Miss Elinor Perry.

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BOSTON, MASS.
September, 1949

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I. NATURE AND SCOPE OF MARKETING PROBLEMS

DEFINITIONS OF MARKETING TERMS

Accessory Equipment. See *Equipment.*

Accounting (in marketing). The Committee tentatively decided to drop this term from the glossary and to substitute a definition of the term *Merchandising Control,* which will be found in its appropriate alphabetical position.

Advertising. Any paid form of non-personal presentation or promotion of ideas, goods, or services by an identified sponsor.

It involves the use of such media as the following: magazine and newspaper space, radio, motion pictures, outdoor media (posters, signs, skywriting, etc.), cards (car, bus, etc.), catalogues, direct mail, directories and references, store signs, programs and menus, novelties (calendars, blotters, etc.), and circulars. This list is intended to be illustrative, not inclusive.

Comment. See *Publicity, "Free" Publicity* for a definition of a kindred activity.

Agent, Agent Middleman. A middleman who negotiates purchases or sales or both but who does not take title to goods.

He usually performs fewer marketing functions than does the merchant middleman. He commonly receives his remuneration in the form of a commission or a fee. He commonly does not represent both buyer and seller in the same transaction.

Examples are: broker, commission merchant, manufacturer's agent, and sales or selling agent.

Comment. The Committee recommends that the term *functional* middlemen no longer be applied to this type of agent. It is hardly logical or consistent in view of the fact that they perform fewer functions than other middlemen.

Assembling. The marketing function of concentrating goods or their control to facilitate sale or purchase.

Retailers and certain wholesale middlemen commonly refer to this function as *buying.*

Source: Preliminary report of the Definitions Committee of the American Marketing Association, R. S. Alexander, Chairman. The final report was published in *The Journal of Marketing*, Vol. XIII, No. 2 (October, 1948), p. 202.

Comment. The concentration involved here may represent a quantity of like goods or a variety of goods. It is primarily that of ownership or control rather than physical in character. It includes the assembling of adequate and representative stocks by wholesalers and retailers.

Branch House. An establishment maintained by a manufacturer or a wholesale distributor primarily for the purpose of carrying stocks of, selling, and delivering his product.

Branch Office. An establishment maintained by a seller for the purpose of selling his product or service.

Comment. The characteristic of the *branch house* that distinguishes it from the *branch office* is the fact that it is used in the physical storage, handling, and delivery of merchandise. Otherwise the two are identical.

Branch Store. A subsidiary retail business owned and operated by an established store and smaller than or carrying a much less extensive line of merchandise than the parent store.

Comment. See *Parent Store* for a kindred term.

Brand. A name, term, symbol, or design, or a combination of them which identifies the goods or services of one seller or group of sellers and distinguishes them from those of competitors.

Comment. A brand may include a brand name, a trade-mark, or both. The term *brand* is sufficiently comprehensive to include practically all means of identification except perhaps the package and the shape of the product. All *brand names* and all *trade-marks* are *brands* or parts of brands, but not all *brands* are either *brand names* or *trade-marks*. *Brand* is the inclusive, general term. The others are more particularized.

Brand Name. A brand or a part of a brand consisting of a word, letter, group of words or letters comprising a name which identifies the goods or services of a seller or group of sellers and distinguishes them from those of competitors.

Comment. The *brand name* is that part of a brand which can be vocalized—the utterable quality resident in it. To illustrate, the brand under which the Buick car is sold is the name "Buick" printed in script and set in the familiar rectangle design which usually appears somewhere on this make of car. This combination also happens to conform to the legal requirements of a trade-mark. The word "Buick" used orally or set in any kind of type face, whatever its surroundings may be, is the brand name. This is true of the pronounceable part of it regardless of the presence or absence of the usually accompanying designs or symbols.

Broker. An agent (agent middleman) who does not have direct physical control of the goods in which he deals but represents either buyer or seller and does business for his principal.

His powers as to prices and terms of sale are usually limited by his principal.

Buying Power. See *Purchasing Power. Purchasing Power* is preferred.

Chain Store. One of a group of retail stores of essentially the same type, centrally owned and with some degree of uniformity of operation.

Comment. According to the dictionary two may apparently be construed to constitute a "group." This usage does not conform to the Census definition of four stores or more.

Commissary Store. A retail store owned and operated by a company or governmental unit to sell primarily to its employees.

Non-governmental establishments of this type are often referred to as *company stores* or *industrial stores.*

Comment. Many of these establishments are not operated for profit. The matter of the location of the control over, and responsibility for, these stores rather than the motive for their operation constitutes their distinguishing characteristic.

Commission Merchant. An agent (agent middleman) transacting business in his own name who usually exercises physical control over the goods consigned to him and negotiates their sale.

The commission merchant usually enjoys broader powers as to prices, methods, and terms of sale than does the broker although he must obey instructions issued by his principal. He generally arranges delivery, extends necessary credit, and collects.

Comment. Most of those who have defined the *commission merchant* state that he has possession of the goods he handles. In its strict meaning the word "possession" connotes to some extent the idea of ownership; in its legal meaning it involves a degree of control somewhat beyond that usually enjoyed by the commission merchant. Therefore, the phrase "physical control" was used instead.

The fact that many *commission merchants* are not typical in their operations does not subtract from their status as *commission merchants.* While the term *merchant* is somewhat of a misnomer as applied to an agent middleman, it is disregarded in this definition since this usage is commonly accepted in the trade.

Consumers' Cooperation, Consumers' Cooperative Marketing. That type of cooperative marketing which involves the purchase of goods and services primarily for use by or resale to the individual ultimate consumers composing the membership.

Comment. According to this definition the term applies only to the cooperative purchasing activities of ultimate consumers and does not embrace collective buying by business establishments, industrial concerns, and institutions.

Consumers' Cooperative Store. A retail store owned and directed by its own associated membership of ultimate consumers.

Groups of these stores sometimes unite to perform their own wholesaling functions.

Consumers' Goods. Goods destined for use by the individual ultimate consumer and in such form that they can be used by him without further commercial processing.

Comment. Certain articles, for example, typewriters, may be either consumers' goods or industrial goods depending upon whether they are destined for use by the individual ultimate consumer or by an industrial, business, or institutional user.

Since individuals vary, the same article may under different circumstances fall into any one of the three classifications of consumers' goods depending upon the specific consumer attitude. In spite of such individual reactions, any particular article is usually or typically bought by consumers in a uniform manner and upon uniform bases of appeal and may, therefore, be said to belong typically to one of the three classes even though in individual situations it may shift from one to another.

Convenience Goods. Those consumers' goods which the customer usually desires to purchase frequently, immediately, and with the minimum of effort.

Examples of merchandise ordinarily bought as convenience goods are: tobacco products, soap, most drug products, newspapers and magazines, chewing gum, small packaged confections, and many grocery products.

Comment. These articles are usually of small unit value and not bulky. The definition, however, is based on the method of purchase employed by the typical consumer. Its essence is consumer attitude and habit.

The convenience involved may be in terms of closeness to home, easy accessibility by some means of transport, or close proximity to the places where people go during the day or evening, for example, downtown to work.

Cooperative Marketing. The process by which groups composed of producers, middlemen, consumers, or combinations of them act collectively in buying or selling or both.

Comment. This term includes only those collective activities that are more or less directly connected with buying and selling.

Department Store. A retail store which handles a wide variety of lines of goods, such as women's ready-to-wear and accessories, men's and boys' wear, piece goods, small wares and house furnishings, and which is organized into separate departments for purposes of promotion, service, accounting, and control.

Examples of department stores are: R. H. Macy & Company in New York, Marshall Field & Company in Chicago, J. L. Hudson Company in Detroit, Jordan Marsh Company in Boston, the Emporium in San Francisco, Carver Brothers in Strasburg, Ohio, A. B. Wyckoff in Stroudsburg, Pa.

Comment. This definition departs from the usual one in that it includes no definite requirements as to classes of goods handled, save only that they shall embrace a wide variety of lines. Most definitions previously suggested for this term set up a list of categories of merchandise which a store must handle before it can be designated as a department store. The emphasis here is placed upon the departmentization feature, provided a wide variety of lines is handled.

This formula probably more nearly conforms to common usage than do those of the more rigid type, and at the same time it includes many stores whose problems and characteristics belong to this group but which would not fall within it if a rigid requirement as to classes of goods handled were applied.

This is roughly the Census definition, except that the Census does not classify a store as a department store unless it has annual sales of at least $100,000.

Departmentized Specialty Store. See *Specialty Store.*

Direct Marketing, Direct Selling. The process whereby the producer sells to the user, ultimate consumer, or retailer without intervening middlemen.

The Committee recommends that when either of these terms is used, it be so qualified as to indicate clearly the precise meaning intended (direct to retailer, direct to user, direct to ultimate consumer, etc.).

Distribution. The Committee recommends that *distribution* be regarded and used as synonymous with *marketing.* It further recommends that in so far as possible its use be discontinued.

Comment. The Committee feels that this term should be used sparingly by marketing men because it has a rather specialized meaning in economic theory, and its indiscriminate use is likely to cause confusion.

For a specialized sense in which it is sometimes used in this field, see *Physical Distribution.*

Equipment. Those industrial goods that do not become a part of the physical product and which are exhausted only after repeated use, such as major installations, or installation equipment, and auxiliary accessories, or accessory equipment.

Installation Equipment includes such items as boilers, linotype machines, power lathes, bank vaults.

Accessory Equipment includes such items as trucks, typewriters, filing cases, and most small tools.

Exclusive Agency Selling. That form of selective selling whereby sales of an article or brand to any one type of buyer are confined to one dealer or distributor in each area, usually on a contractual basis.

Comment. This definition does not include the practice of designating two or more distributors or dealers in an area as selected outlets. While this practice is a form of *selective selling* it is not *exclusive agency selling.*

It is recommended that the term *joint agency* be applied to this arrangement.

Fabricated Materials. Those industrial goods which in part or in whole become a portion of the physical product and which have undergone processing beyond that required for raw materials.

Factor. 1. A type of commission merchant who often advances funds to the consignor, identified chiefly with the raw cotton and naval stores trades.

2. A specialized commercial banker performing the function of financing for producers of and dealers in many varieties of products and occasionally combining this function with that of selling.

The term *factor* was formerly synonymous with *commission merchant.*

General Store. A retail store which carries a variety of non-related merchandise, including groceries, hard goods, and soft goods, and which is not departmentized.

Comment. The type is most generally and most typically found in country districts. However, the term is not confined to stores serving the country and village trade but includes retail establishments in cities as well. This conforms roughly to the Census usage.

Some country stores in western states are departmentized. It is possible that they are *departmentized specialty stores* instead of *general stores*, although the term *general stores* is applied to them as a matter of custom.

Grading. Grading is the process of sorting individual specimens of a given product into the standard grades or classes to which they belong.

Comment. This term is often defined so as to include the work of setting up classes or grades. This process is really a part of *standardization.*

Gross Profit, Gross Margin (for purposes of marketing). Sales less Cost of Goods Sold (adjusted for inventory depreciation and merchandise shortages).

House-to-House Salesman. A salesman who is primarily engaged in making sales direct to ultimate consumers in their homes.

Comment. The word *canvasser* is often employed as synonymous with *house-to-house salesman.* Due to its extensive use in fields other than marketing, this usage is not recommended.

Independent Store. A retail store which is controlled by its own individual ownership or management rather than from without, except in so far as its management is affected by voluntary group arrangements.

Comment. This definition includes a member of a voluntary group organization. It is recognized that the voluntary group possesses many of the characteristics of and presents many of the same problems as the chain store system. In the final analysis, however, the members of voluntary groups are *independent stores* cooperating, perhaps temporarily, in the accomplishment of certain marketing purposes. Their collective action is entirely voluntary, and the retailers engaging in it consider themselves to be independent.

Industrial Goods. Goods which are destined for use in producing other goods or rendering services as contrasted with goods destined to be sold to the ultimate consumer.

They include land and buildings for business purposes, equipment (installation and accessory), operating supplies, raw materials, fabricated materials.

Comment. The distinguishing characteristic of these goods is the purpose for which they are destined to be used, in carrying on business or industrial activities rather than for consumption by individual ultimate consumers or resale to them. The category also includes merchandise destined for use in carrying on various types of institutional enterprises.

Relatively few goods are exclusively industrial goods. The same article under one set of conditions may be an industrial good and under other conditions, a consumers' good.

In its 1935 Report the Committee sought to pioneer the use of the term *business goods* as a synonym for *industrial goods*. Since this suggested usage does not seem to have achieved any significant degree of acceptance, it is now abandoned.

Industrial Store. See *Commissary Store.*

Installation Equipment. See *Equipment.*

Jobber. This term is now widely used as a synonym for *wholesaler.*

Comment. Formerly the *jobber* was a dealer in odd lots, but this usage has practically disappeared. The term is sometimes used in certain trades and localities to designate special types of wholesalers. This usage is especially common in the distribution of agricultural products. The characteristics of the wholesalers so designated vary from trade to trade and from locality to locality.

Most of the schedules submitted to the Bureau of the Census by the members of the wholesale trade show no clear line of demarcation between those who call themselves *jobbers* and those who prefer to be known as wholesalers. It does not seem wise therefore to attempt to set up any general basis of distinction between the terms in those few trades or markets in which one exists. There are scattered examples of special distinctive usage of the term *jobber.* The precise nature of such usage must be sought in each trade or area in which it is employed.

Joint Agency. See *Exclusive Agency Selling.*

Mail Order House (retail). A retail establishment that receives its orders and makes its sales by mail.

Comment. Other types of retail stores often conduct a mail order business, usually through departments established for that purpose, although this fact does not make them *mail order houses.* On the other hand, some organizations that originally confined themselves to the mail order business now also operate chain store systems. For example, Sears, Roebuck and Company and Montgomery Ward & Company are both *mail order houses* and *chain store systems.*

Manufacturer's Agent. An agent middleman who generally operates on an extended contractual basis; sells within an exclusive territory; handles noncompeting but related lines of goods; and possesses limited authority with regard to prices and terms of sale.

He may be authorized to sell a definite portion of his principal's output.

Comment. The *manufacturer's agent* has often been defined as a species of broker. In the majority of cases this seems to be substantially accurate. However, in 1939, out of a total of 9,778 *manufacturer's agents* reporting to the Bureau of the Census, 1,907, or about 19%, carried stocks. It is probably more accurate in trying to define the entire group not to classify them as a specialized type of broker but to regard them as a special variety of agent middlemen.

Manufacturer's Brand, Producer's Brand. See *National Brand.*

Manufacturer's Store. A store owned and operated by a manufacturer. Such stores may serve as an established channel for the distribution of the manufacturer's products; in other cases they may be used for experimental or publicity purposes.

Market. 1. An aggregate composed of a prospective buyer or buyers and a seller or sellers of specific merchandise or services.

2. The place or area in which these buyers and sellers function.

3 (as a verb). The performing of business activities directed toward and incident to the flow of goods and services from producer to consumer or user.

Comment. In view of the diverse usage of this term, it is recommended that those using it indicate in connection with each use the sense in which it is employed.

These definitions lack something of the precision and completeness of the theoretic economic concept of a *market* as a group of buyers and sellers of a commodity in communication with each other whose activities serve to equate the forces of supply and demand. It seems best to adhere to those usages of terms that are commonly employed in business or in professional marketing literature rather than to those of economic theory.

Market Financing. That part of the general business function of providing and managing funds and credit which is directly related to the transactions involved in the flow of goods and services from producer to consumer.

Comment. This definition includes the provision and management of funds needed to finance the carrying of stocks and the granting of mercantile and retail credit, including installment credit. It does not include the provision of funds to purchase a building in which to carry on a marketing enterprise nor does it embrace consumer borrowing on a personal basis.

Roughly it includes financial operations that are undertaken to control or modify the direction of the flow of goods and services in marketing but eliminates those which are of a more general nature.

Market Planning, Sales Planning. The work of setting up objectives for marketing activity, and of determining and scheduling the steps necessary to achieve such objectives.

Comment. This term includes not only the work of deciding upon the goals or results to be attained through marketing activity but also the determination in detail of exactly how they are to be accomplished. The result of this work is a *marketing plan.*

Market Potential. The expected sales of a commodity, a group of commodities, or a service for an entire industry in a market.

Comment. The use of this concept should be considered in relation to that of *sales potential.*

Market Research. A field of *marketing research* which includes the means and methods of measuring the extent of a market and determining its characteristics.

Comment. This is a static concept as over against that of marketing research which includes the study of the dynamics of the marketing process as well as the formulation of a picture of a given market which is the end product of market research.

Marketing. The performance of business activities directed toward, and incident to, the flow of goods and services from producer to consumer or user.

Comment. This definition seeks to exclude from marketing activities resulting in changes in the form of merchandise which represent material modifications in its characteristics or uses. It seeks to include such activities when they result in changes in form primarily designed to make the product more salable and only incidentally to affect its use, such as packaging.

The task of defining marketing may be approached from at least three points of view.

1. The "legalistic" of which the following is a good example: "Marketing includes all activities having to do with effecting changes in the ownership and possession of goods and services." It seems obviously of doubtful desirability to adopt a definition which throws so much emphasis upon the legal phases of what is essentially a commercial subject.

2. The "economic," examples of which are:

"That part of economics which deals with the creation of time, place, and possession utilities."

"That phase of business activity through which human wants are satisfied by the exchange of goods and services for some valuable consideration."

Such definitions are apt to assume somewhat more understanding of economic concepts than are ordinarily found in the market place.

3. The "factual or descriptive," of which the definition suggested by the Committee is an example. This type of definition merely seeks to describe its subject in terms likely to be understood by both professional economists and businessmen without reference to legal or economic implications.

Marketing Facilitating Agencies. Those agencies which perform or assist in performing any one or a number of the marketing functions but which neither take title to goods nor negotiate purchases or sales.

Common types are banks, railroads, storage warehouses, commodity exchanges and markets, stock yards, insurance companies, graders and inspectors, advertising agencies, market counsellors, cattle loan companies, furniture marts, and packers and shippers.

Comment. Writers on marketing at one time classified these agencies as *functional middlemen* including also in that classification all types of non-title-taking middlemen. This mixture of incongruous elements hardly seems desirable. The groups included in the above definition are not *middlemen* as that term is defined by the Committee.

Marketing Function. A major specialized activity performed in marketing.

Comment. There is no generally accepted list of *marketing functions.* Probably those most generally recognized are transportation or traffic management, storage, market financing, risk management, selling, grading, assembling, standardizing, and buying. Merchandising is sometimes included in the list although many writers regard it as a broader business function lying between marketing and production.

Some of these activities are broad business functions having special marketing implications. Others are peculiar to the marketing process. In the first category are traffic management, market financing, and risk management. In the second group are buying, selling, and assembling.

It is probably unfortunate that this term ever developed. Under it students of marketing have sought to squeeze a heterogeneous and non-consistent group of activities. For example, the functions of assembling and dividing, if such functions exist, are performed through buying, selling, and transporting. Grading, standardization, and packaging are adjuncts of selling. Merchandising, when performed by the manufacturer, is partly a production and partly a marketing activity. Such functions as assembling, storage, transporting are broad, general economic functions, while selling and buying are essentially individual in character. All these discrete groups we attempt to crowd into one class and label *marketing functions.*

Marketing Plan. A program covering all methods and procedures for marketing the product or products of a company.

Marketing Policy. A course of action established to secure consistency of marketing procedure under recurring and essentially similar circumstances.

Marketing Research. The gathering, recording, and analysis of all facts about problems relating to the transfer and sale of goods and services from producer to consumer.

Among other things it involves the study of relationships and adjustments between production and consumption, preparation of commodities for sale, their physical distribution, wholesale and retail merchandising, and financial problems concerned. Such research may be undertaken by impartial agencies or by specific concerns or their agents for the solution of their marketing problems.

Comment. Marketing Research is the inclusive term which embraces all research activities carried on in connection with the management of marketing work. It includes various subsidiary types of research, such as *market research, sales research* which is largely an analysis of the sales records of a company, *consumer research* which is concerned chiefly with the discovery and analysis of consumer attitudes, reactions, and preferences, and *advertising research* which is carried on chiefly as an aid to the management of advertising work.

Merchandising. The planning to offer the right merchandise at the right place, at the right time, in the right quantities, and at the right price.

Comment. This term has been used in a great variety of meanings, most of them confusing. The usage recommended by the Committee has the advantage that it adheres closely to the natural and essential meaning of the word. The activity described here might also be called merchandise, or product, planning. Included in the activity are such tasks as selecting the product to be produced or stocked and deciding such details as the size, appearance, form, dressing of the product (packaging, etc.), quantities to be bought or made, time of purchase or production, price lines to be carried or made, etc.

Merchandising Control. The Committee prepared two tentative formulas for this term. They are as follows:

1. The analysis, planning, and administration of sales, stocks, and pricing practices for the purpose of effecting the profitable purchase and sale of merchandise.
2. The collection and analysis of statistical facts about sales and stocks for the purpose of merchandising.

Merchant, Merchant Middleman. A middleman who takes title to goods. Such middlemen usually perform most or all of the distributive functions.

Comment. The distinguishing feature of this middleman lies in the fact that he takes title to the goods he handles. The extent to which he performs the marketing functions is incidental. Wholesalers and retailers are the chief types of merchant middlemen.

Middleman. A business concern that specializes in performing functions or rendering services immediately involved in the purchase and/or sale of goods in the process of their flow from producer to consumer.

Middlemen are of two types: merchants, or merchant middlemen, and agents, or agent middlemen.

Comment. The essence of the *middleman's* operation lies in the fact that he plays an active and prominent part in the negotiations leading up to transactions of purchase and sale. This is what distinguishes him from a *marketing facilitating agent* who, while he performs certain marketing functions, participates only incidentally in negotiations of purchase and sale.

Middleman's Brand, Distributor's Brand. See *Private Brand.*

Missionary Salesman. A salesman employed by a manufacturer to contact the customers of his distributors.

This is usually for the purpose of developing goodwill and stimulating demand; often he takes orders for delivery by such middlemen or helps or induces them to promote the sale of his employer's goods or helps train their salesmen to do so.

Comment. This term has been used to designate any sort of salesman who is primarily engaged in goodwill work. The definition above gives it a much narrower meaning. The term should not be confused with the so-called "missionary" sales work which usually covers a much more varied type of sales activity than that done by the *missionary salesman.*

National Brand. A manufacturer's or producer's brand, usually but not necessarily advertised and sold over a considerable part of the country.

Comment. In its 1935 Report the Committee sought to discourage the use of the terms *national* and *private brand* on the ground that they were illogical and not descriptive. The Report suggested that they be replaced by the terms *manufacturer's brand* or *producer's brand* and *distributor's brand* or *middleman's brand.*

The Committee's attempt to set up a logical system of nomenclature in this field was completely unsuccessful. Accordingly it is abandoning the attempt and endeavoring to define the terms actually used in their common usage. The nomenclature is just as illogical as it ever was in the Committee's opinion, but both writers on and practitioners of marketing use it; so the Committee endorses it.

Net Profit, Net Gain, Net Income. Final income available for proprietary accounts (either before or after deduction of Federal and State income taxes as specifically indicated).

It includes operating profit together with net other income.

Comment. Net profit is recommended as the preferred term among the three.

Operating Profit (for purposes of marketing). Gross profit less operating expenses (including salaries of managers, whether proprietors or employees), fixed plant and equipment cost, and sometimes interest on invested capital.

Comment. Obviously this definition includes only the profit accruing from the trading operations of a mercantile business.

Organized Market. A group of traders organized for the purpose of buying and selling a single commodity or a small group of related commodities.

Parent Store. A retail store that owns and operates a *branch store* or a group of *branch stores.*

Personal Salesmanship. Oral presentation in a conversation, usually with one or more prospective customers, for the purpose of selling.

Comment. This definition contemplates that the presentation may be either formal (as a "canned" sales talk) or informal, although it is rather likely to be informal; either in the actual presence of the customer or by telephone, although more frequently the former; either to an individual or to a small group, although usually the former.

Physical Distribution. The movement and handling of goods from the point of production to the point of consumption or use.

Comment. The word *distribution* is sometimes used to describe this same activity. In view of the technical meaning of this word in economic theory and of the fact that it is used by the Bureau of the Census and increasingly by marketing students and businessmen as synonymous with *marketing,* the

Committee feels that its use in the narrower sense should be discouraged. The term *physical distribution* is therefore suggested to serve the narrower purpose.

Predatory Price Cutting. The Committee suggests that this term be dropped from marketing usage.

Comment. By the basic nature of the words that make it up, this term must involve the concept of the intent of the price cutter. It is so hard to prove when a price cutter is seeking to "get" competitors rather than to get customers that it seems best to drop the term.

Price Cutting. Offering merchandise or a service for sale at a price below that recognized as usual or standard by the buyers and sellers in a market.

Comment. One obvious criticism of this definition is that it is indefinite. But that very indefiniteness also causes it to be more accurately descriptive of the subject concept which is characterized by a high degree of indefiniteness in the mind of the average person affected by price cutting.

Traders' ideas of what constitutes price cutting are so vague and indefinite that any precise or highly specific definition of that phenomenon is bound to fail to include all its manifestations. If you ask a group of traders in a specific commodity to define price cutting, you will get as many conflicting formulas as there are traders. But if you ask those same traders at any particular time whether selling at a certain price constitutes price cutting, you will probably get a considerable degree of unanimity of opinion. It is precisely this condition which the definition is designed to reflect.

Private Brand. A brand sponsored by a distributor as distinguished from one sponsored by a manufacturer or a producer.

Comment. This usage is thoroughly illogical, since no seller wants his brand to be private in the sense of being secret, and all brands are private in the sense that they are special and not common or general. But the usage is common in marketing literature and among traders. Therefore, the Committee endorses it.

Producers' Cooperative Marketing. That type of cooperative marketing which primarily involves the sale of goods or services of the associated producing membership.

Comment. Many producers' cooperative marketing associations both buy and sell for their members. This fact does not subtract from their status as producers' cooperatives; this is especially true of the farm cooperatives.

The term does not include those activities of trade associations that affect only indirectly the sales of the membership. Such activities are the maintenance of credit rating bureaus, design registration bureaus, and brand protection machinery. It does include, however, such things as cooperative advertising.

Publicity, "Free" Publicity. Any form of commercially significant news about a product, an institution, a service, or a person published in space or radio time that is not paid for by the sponsor.

Comment. In the retail trade this term is often used to include such activities as advertising and display work.

In one sense this term is a misnomer. It is doubtful if any publicity is ever entirely free. That which is apparently free is often in the final analysis most costly indeed.

Purchasing Power, Buying Power. The capacity to purchase possessed by an individual buyer, a group of buyers, or the aggregate of the buyers in an area or a market.

Raw Materials. Those industrial goods which in part or in whole become a portion of the physical product but which have undergone no more processing than is required for convenience, protection, or economy in storage, transportation, or handling.

Retailer. A middleman who sells mainly to the ultimate consumer.

Comment. The *retailer* is to be distinguished by the conditions surrounding the sale rather than the purchase of the goods in which he deals. Attempts to draw the definition on the basis of the size of the units in which he sells prove not to be defensible. The size of his sales unit is an incidental rather than a primary element in his character. His essential distinguishing mark is the fact that his typical sale is made to the ultimate consumer.

Retailing. The activities incident to selling to the ultimate consumer.

The goods sold may be produced, bought, or handled by the seller.

Comment. This definition includes all forms of selling to the ultimate consumer. It embraces the direct-to-consumer sales activities of the producer whether through his own retail stores, by house-to-house canvass, or by mail order. It does not cover the sale by producers of industrial or business goods, by industrial supply houses, by wholesalers, or by retailers to industrial, commercial, or institutional buyers for use in the conduct of their enterprises.

Risk Management. The function of reducing, spreading, or avoiding the loss of pecuniary value of goods and services during their marketing.

Such losses may occur through physical deterioration, obsolescence, theft, damage, waste, or through changes in supply or demand or through changes in the price level.

Comment. Some criticism may attach to the designation of this function as *risk management* since it often happens that not much can be done in the way of managing risks. They come as they will regardless of attempts to manage them.

The term has many advantages, however, over *risk bearing* which is often applied to this type of activity. Not all risks arising in distribution are borne by those engaged in it. Many of them are avoided, and many others are changed in character or intensity as a result of good management on the part of marketing concerns.

Losses are of two types, those that are insurable, such as fire and accident, and those that are not insurable, such as the losses from changes in price.

Sales Budget. An estimate of the probable dollar sales and probable expenses of selling for a specified period.

Comment. The use of this term is sometimes confined to an estimate of future sales. This does not conform to the general use of the term *budget* which includes schedules of both receipts and expenditures. If the sales budget is to be used as a device to facilitate sales control and management, it should include the probable cost of getting the estimated volume of sales. The failure to include this item in their calculations is one of the most consistently persistent and fatal mistakes made by American business concerns. It has led to much of the striving after unprofitable volume that has been so costly.

Sales Control. A system of supervision involving the use of such devices as records, statistical analyses, correspondence, and personal contact for the purpose of carrying out or adjusting marketing policies and plans.

Comment. The application of this term is often confined to the operation of a system of records and forms from which a picture of sales operations may be obtained. The recommended usage goes much farther and includes the practical use that may be made of such a picture once it is obtained.

Sales Forecast. An estimate of dollar or unit sales for a specified future period under a given marketing plan or program.

The forecast may be for a specified item of merchandise or for an entire line; it may be for a market as a whole or for any portion thereof.

Comment. Two sets of factors are involved in making a *sales forecast:* (1) those forces outside the control of the firm for which the forecast is made which are likely to influence its sales, and (2) changes in the marketing methods or practices of the firm that are likely to affect its sales.

In the course of planning future activities the management of a given firm may make several *sales forecasts,* each consisting of an estimate of probable sales if a given marketing plan is adopted. The estimated effects on sales of a number of marketing plans may be compared in the process of arriving at that marketing program which will, in the opinion of the officials of the company, be best designed for its welfare.

Sales Management. The planning, direction, and control of personal salesmanship, including recruiting, selecting, training, equipping, assigning, routing, supervising, paying, and motivating as these tasks apply to the personal salesforce.

Sales Manager. The executive who plans, directs, and controls the activities of salesmen.

Comment. This executive may and often does perform broader functions in the distribution work of his company, but the essential nature of his position lies in his relation to the personal selling work of the firm.

Sales Planning. See *Market Planning.*

Sales Potential. The share of a *market potential* which a company expects to achieve.

Comment. This is the portion which the managers of a firm expect it to get of the total sales of the industry to which the firm belongs. In a sense it is the over-all sales task which the managers of a firm set for their company.

It must be considered in relation to the concept of a ***market potential.***

Sales Promotion. 1. In its general sense, all activities designed to increase sales.

2. In a special sense, those sales activities that belong neither to personal selling nor to advertising but are necessary in coordinating them and making them effective, such as displays, shows and expositions, demonstrations, and other non-recurrent selling efforts not in the ordinary routine.

3. In a special sense, the planning and conduct of special sales events.

Comment. This three-fold definition constitutes a surrender on the part of the Committee to the wide-spread and substantially complete confusion among marketing men in their use of this term. The Committee is not enthusiastic about it but regards the definition in the light of an attempt to standardize unstandardization in the usage of this term.

The third usage is found chiefly in the retail trade, especially among department stores.

Sales Quota. A sales goal for a specified period in dollars or units which is used in the management of sales efforts.

The quota may be used in checking the efficiency, stimulating the efforts, or in fixing the payment of individual salesmen or groups of salesmen or other personnel engaged in sales work.

Comment. A quota may be for a salesman, a territory, a ranch house, or for the company as a whole. It is a managerial device. It is not, therefore, necessarily an immutable figure arrived at by the application of absolutely exact statistical formulas but may be set up with an eye to its psychological effects upon the sales personnel or any part of it. Two salesmen working in territories of identical potentials may be assigned different quotas in accordance with the anticipated effects of this variation on their sales efforts because of differences in their characters or personalities.

Selective Selling. The policy of selling only to accounts meeting the seller's requirements or of varying marketing services by classes of customers.

Comment. While accounts are selected on a variety of bases, probably the most common are size and the kind and amount of reselling service the account is willing and able to give to the goods or services of the seller. Possibly the soundest basis is that of the amount of potential net profit to be derived from the business placed by the account.

Selling. The personal or impersonal process of assisting and/or persuading a prospective customer to buy a commodity or a service or to act favorably upon an idea that has commercial significance to the seller.

Comment. This definition includes advertising, other forms of publicity, and sales promotion as well as personal selling.

Selling Agent. An agent middleman who generally operates on an extended contractual basis, sells the entire output of his principal, and has full authority with regard to prices, terms, and other conditions of sale. He occasionally renders financial assistance to his principal.

Services. Intangible or impersonal activities or anticipated satisfactions which are offered for sale either as such or in connection with the sale of goods.

Examples are amusements, hotel service, electric service, transportation, the services of barber shops and beauty shops, repair and maintenance service, the work of advertising agencies and credit rating bureaus. This list is merely illustrative, and no attempt has been made to make it complete.

Shopping Goods. Those consumers' goods which the customer in the process of selection and purchase characteristically compares on such bases as suitability, quality, price, and style.

Examples of goods that most consumers probably buy as *shopping goods* are: millinery, furniture, dress goods, men's and women's ready-to-wear, shoes, jewelry, and residential real estate (not bought for purposes of speculation).

Comment. It should be emphasized that a given article may be bought by one customer as a *shopping good* and by another as a *specialty* or *convenience good.* The general classification depends upon the way in which the average or typical buyer purchases.

See comment under *Specialty Goods.*

Simplification. The process of reducing the varieties of goods within a line offered for sale.

Comment. It involves reducing the number of articles, parts, materials, models, styles, grades, colors, sizes, price lines, brands, designs, etc.

Specialty Goods. Those particular consumers' goods on which a typical buyer characteristically insists and for which he is willing to make a special purchasing effort.

Examples of merchandise that is usually bought as specialty goods are: fancy groceries, high-class watches, men's high-grade shoes, and possibly automobiles.

Comment. There is considerable difference of opinion among the members of the Committee as to whether the distinction between *shopping goods* and *specialty goods* is any longer valid or useful. There is less doubt of the validity of the class, *shopping goods*, than of *specialty goods.*

Teachers who make use of the two terms seem to have considerable difficulty finding articles that are habitually bought as *specialty goods.* This is not true of *shopping goods.* There also seems some doubt as to whether the methods of purchase are really so significantly different that the methods of distribution differ to any great extent.

Specialty Salesman. A salesman, other than retail, who specializes in the sale of one or a few products of a line.

Comment. A *specialty salesman* should be contrasted with a *general salesman* who handles an entire line. He does not necessarily sell specialty goods.

Specialty Shop. See *Specialty Store.*

Specialty Store. A retail store that makes its appeal on the basis of specialty goods or on the basis of a restricted class of shopping goods.

Large *specialty stores*, if organized into departments, are called *departmentized specialty stores.* Small *specialty stores* in certain fields are sometimes called *specialty shops.*

Comment. This term should not be used to include stores handling one or a few lines of goods, such as staple groceries, hardware, stationery, and tobacco.

Standardization. The determination of basic limits or grades in the form of specifications to which manufactured goods must conform and classes into which the products of agriculture and the extractive industries may be sorted.

Comment. This term does not include *grading* which is the process of sorting units of a product into the grades or classes that have been established through the process of *standardization.*

Storage. The marketing function that involves holding goods between the time of their production and their use.

Comment. Some processing is often done while goods are in *storage.* It is probable that this should be regarded as a part of production rather than of marketing.

Store Unit. A single retail establishment of a chain store system or other group.

Comment. The members of the Committee are not in entire agreement as to whether this term would be most useful if its meaning were broad enough to include establishments belonging to ownership groups, voluntary groups, and cooperative groups.

Supplies. Those industrial goods which do not become a part of the physical product and which are continually exhausted in facilitating the operation of an enterprise.

Examples are: fuel, lubricants, stationery, typewriter ribbons, cleaning materials, etc.

Textile Factor. This term has been dropped since the type of operation to which it applied has been included as one part of the definition of the more general term *factor.*

Trade-Mark. A brand that is given legal protection because it is capable of exclusive appropriation; because it is used in a manner sufficiently fanciful, distinctive, and arbitrary; because it is affixed to the product when sold, or because it satisfies the requirements of the Federal Trade-Mark Law.

Comment. Non-registered trade-marks receive this protection under the common law; registered trade-marks receive it under the provisions of the Federal Trade-Mark Law.

Trade-Mark is essentially a legal term and includes only those brands or parts of brands which the law designates as *trade-marks*. In the final analysis, a *trade-mark* in any specific case is what the court in that case decides to regard as a *trade-mark*.

Trade Name. 1. The name by which an article or a certain type or grade of an article is known among traders.

2. The name under which a business is conducted.

Comment. Credit is acknowledged to *Webster's New International Dictionary*.

Trading Area. A district whose boundaries are usually determined by the economical selling range for a commodity or group of related commodities sold by a middleman or a group of middlemen located within the district.

Trading areas are not static but are in a constant state of flux.

Comment. Since the 1935 Report of the Committee considerable study has been devoted to the *trading area* concept. It is still nebulous; but much has been learned about it, and much more is in the process of being learned.

Traffic Management. The planning, selection, and direction of all means of transportation involved in the movement of goods in the marketing process.

Comment. This definition is confined to those activities in connection with transportation that have to do particularly with marketing and form an inseparable part of any well-organized system of distribution. It includes the movement of goods in trucks owned by the marketing concern as well as by public carrier. It does not include the movement of goods within the warehouse of a producer or distributor or within the store of a retail concern.

Ultimate Consumer. One who buys and/or uses goods or services to satisfy personal or household wants rather than for resale or use in business, institutional, or industrial operations.

Comment. There seems to be a growing tendency to drop the word *ultimate* from this term. The Committee recommends that this tendency be encouraged.

The definition distinguishes sharply between *industrial users* and *ultimate consumers*. A firm buying and using an adding machine, a drum of lubricating oil, or a carload of steel billets is an industrial user of those products, not an *ultimate consumer* of them; under the developing usage it is not even a *consumer* of them. A vital difference exists between the purposes motivating the two types of purchases which in turn results in most significant differences in buying methods, marketing organization, and selling practices.

Unit Store. The Committee recommends that the use of this term be discontinued because it is so nebulous and diverse in usage that it leads to misunderstanding and looseness of statement and thought.

Comment. The definition of this term in the 1935 Report of the Committee was:

1. A synonym for *independent store* when applied to a concern handling a limited line of goods.

2. Sometimes used to indicate a retail store handling an assortment of one line or several closely related lines of merchandise.

3. Sometimes used to mean an individual unit of a chain store system. The Committee has suggested the term *store unit* for this purpose.

4. Any store in a single location.

Variety Store. A retail store that handles a wide assortment of goods usually of a low or limited price.

Examples are the five-and-ten store and the up-to-a-dollar store.

Comment. This is often called a *limited price variety store.* The validity of these terms and of the limited price feature of the definition is being dissipated by the tendency of these establishments to handle merchandise more or less without regard to price.

Voluntary Group Store. One of a group of retailers each of whom owns and operates his own store either associated with a wholesaler (in rare cases with a manufacturer) or acting cooperatively, but who are organized to carry on joint merchandising activities and are characterized by some degree of uniformity of operation.

Such joint activities have been largely of three kinds: (1) cooperative buying, (2) cooperative advertising, (3) group control of store operation.

Comment. These organizations take three forms: (1) wholesaler-sponsored, (2) those grouped around a retailer-owned warehouse, (3) those based on a retail buying group.

Wholesaler. A merchant middleman who sells to retailers and other merchants and/or to industrial, institutional, and commercial users but who does not sell in significant amounts to ultimate consumers.

In the basic materials, semi-finished goods, and tool and machinery trades merchants of this type are commonly known as *dealers*, *distributors*, or *supply houses.*

Comment. Generally these merchants render a wide variety of services to their customers. Those who render all the services normally expected in the wholesale trade are known as *service wholesalers;* those who render only a few of the wholesale services are known as *limited function wholesalers.* The latter group is composed mainly of *cash and carry wholesalers* who do not render the credit or delivery service, *drop shipment wholesalers* who sell for delivery by the producer direct to the buyer, *truck wholesalers* who combine selling, delivery, and collection in one operation, and *mail order wholesalers* who perform the selling service only by mail.

This definition ignores or minimizes two bases upon which the term is often defined: first, the size of the lots in which wholesalers deal, and second, the fact that they habitually sell for resale. The figures show that many wholesalers operate on a very small scale and in small lots. Most of them make a significant portion of their sales to industrial users.

Wholesaler's Store. A retail store owned and operated by a wholesaler usually for experimental and publicity purposes.

MARKET POTENTIALS, 1948

BY ARNO H. JOHNSON

Business opportunities in 1948, from the sales standpoint, are potentially far greater than most people recognize. Let me stress the word "opportunities." I am not making predictions, not prophesying what *will* happen. I am simply pointing out what *can* happen if we have the courage, the aggressiveness, and the management skill to turn the potentials into reality—the potentials of increased productivity and purchasing power that the war left us.

For the last three years the majority of our economists and writers have been so intent on watching for the signals of an impending break that they have failed to point out the positive opportunities for this nation to utilize its war-proven productivity in establishing and maintaining higher levels in our standards of living. They just can't believe that we can avoid returning to the prewar levels of depression and unemployment. It is my purpose here to outline those positive factors of increased productivity and purchasing power that so many have overlooked.

TODAY'S HIGH LEVELS

The war proved the people of this nation to be capable of a productivity far beyond what had been recognized or utilized in the past. This greater productivity has been translated from war to peace so successfully that the new levels of real purchasing power made possible by it are hard to reconcile with the prewar levels; it has been difficult to adjust the sights of business and industry to the new opportunities.

Actually the productivity per capita in the United States in the first half of 1947 was 33% greater than in 1940—after full correction for the changing value of the dollar. In other words, the gross national production of all goods and services in the first half of 1947 in terms of 1940 dollars was at a level 33% greater per capita than in 1940. If the current trend continues, the 1948 level of productivity per capita will be 36% over the 1940 level. (See Exhibit I.)

This increased productivity has resulted directly in a correspondingly great increase in the per capita real purchasing power, which in the first half of 1947 also stood at a level 33% greater than in 1940—again after full correction for increased taxes and increased prices.

VAST INCREASE IN CONSUMER PURCHASING POWER

It is estimated that in 1948 the surplus income of individuals available for discretionary spending or saving will be about three-and-a-half times the high-

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Source: *Harvard Business Review*, Vol. XXV, No. 3 (Spring, 1948), pp. 11–31. Reprinted by permission.

EXHIBIT I

INCREASES IN PER CAPITA PRODUCTIVITY AND PURCHASING POWER FROM 1940 TO THE FIRST HALF OF 1947

	1940	1947 *	% Increase over 1940	1948 Opportunity	% Increase over 1940
Population (in thousands)	131,970	143,338	9%	145,400	10%
Number employed civilians (in thousands)	47,520	57,009	20	58,000	22
Consumer Price Index (1935–1939 = 100)	100	155	55	160	60
Federal Reserve Board Index of industrial production (1935–1939 = 100)	125	189	51	197	58
Productivity:					
Gross National Product (in billions)	$ 100.5	$ 225.0	124	$ 240.0	139
Real Gross National Product in 1940 dollars (in billions)	$ 100.5	$ 145.2	44	$ 150.0	49
Per capita	$ 761	$1,013	33	$1,032	36
Per employed civilian	$2,115	$2,547	21	$2,586	22
Purchasing power:					
Disposable personal income (in billions)	$ 75.7	$ 169.6	124	$ 183.5	142
Real disposable personal income in 1940 dollars (in billions)	$ 75.7	$ 109.4	45	$ 114.7	52
Per capita	$ 574	$ 763	33	$ 789	37
Disposable income as % of Gross National Product	75%	75%	.....	76%	

* On basis of annual rate, first half-year.

Source: 1940 and first half of 1947 based on figures from the *Midyear Economic Report* of the President, July 21, 1947. Opportunity for 1948 is based on continuation of rate reached in late 1947.

est prewar levels. This is after full account has been taken of the higher tax level and allowance has been made for a 60% increase since 1940 in consumer prices applicable to basic living costs. This surplus or discretionary spending power probably will be at an annual rate of $94.2 billion compared with $26.5 billion in 1940. This figure does not even include any of the huge backlog of savings that have accumulated in the last seven years. The increase in consumer purchasing power is shown in Exhibit II, which compares probable 1948 conditions with 1940. The increase in the aggregate is shown graphically in Exhibit III and on an average family basis in Exhibit IV.

The average United States family had an income of $2,240 (arithmetic average, not median average) in 1940, of which $74 went for personal taxes and $1,408 for food, clothing, housing, and household operation, leaving $758 of surplus income for discretionary spending for items other than food, clothing, and shelter, or for saving.

At present trends the average United States family income for 1948 is estimated at $5,174, of which $543 must be set aside for personal taxes. To main-

EXHIBIT II

BREAKDOWN OF INCREASE IN CONSUMER PURCHASING POWER FROM 1940 TO 1948

	1940	1948 Estimated *	% Increase 1948 over 1940
Total U.S.—all families (in billions of dollars):			
Total personal income	$ 78.3	$ 205.0	162%
Less personal taxes	2.6	21.5	727
Total disposable personal income after taxes	$ 75.7	$ 183.5	142
Basic living costs to maintain 1940 standard of living †	49.2	89.3	82
Surplus income for discretionary spending or saving	$ 26.5	$ 94.2	255
Personal saving	3.7	11.6	214
Net balance for discretionary spending	$ 22.8	$ 82.6	262
Average per family:			
Estimated number of families	34,949	39,625	13½
Total personal income, per family	$2,240	$5,174	131
Less personal taxes	74	543	634
Disposable income	$2,166	$4,631	114
Basic living costs to maintain 1940 standard of living †	1,408	2,253	60
Surplus income for discretionary spending or saving	$ 758	$2,378	214

* On basis of late 1947 annual rate.

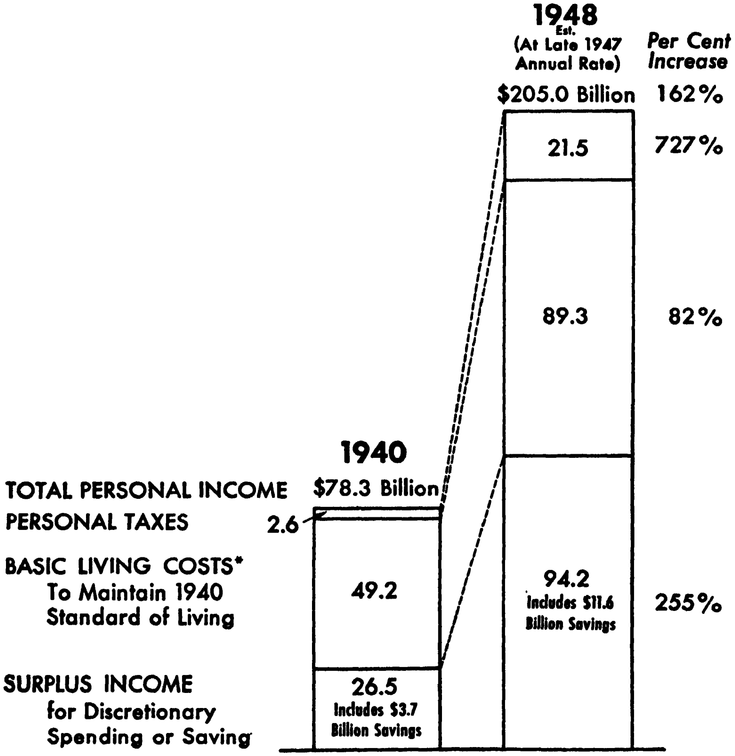
† Basic living costs for food, clothing, and shelter in 1940; includes all food and beverages, clothing and accessories (except jewelry), housing, household operation (including furniture, refrigerators, domestic service, telephone and telegraph, fuel, etc.) as reported under Personal Consumption Expenditures in "National Income and Product Statistics," Supplement to *Survey of Current Business*, July, 1947. To maintain the 1940 basic standard of living for food, clothing, and shelter, the average family in 1948 would have to spend 60% more on the basis of the estimated level of the Consumer Price Index of the United States Department of Labor (estimated index at 160).

tain the same standard of living as in 1940 for food, clothing, and shelter would now require $2,253, or 60% more than the $1,408 in 1940. After deducting the increased taxes and the increased costs of food, clothing, and shelter to maintain a 1940 level of living, the average family would now have $2,378 of surplus income, or three times as much as the $758 it had in 1940. It is impressive to note that this surplus income of $2,378 alone is greater than the *total* family income of $2,240 in 1940.

This comparison of purchasing power available to the average family now as against 1940 gives some idea of the potential increase in the market for goods and services as compared with the best prewar levels. The threefold increase in discretionary family spending power can be used by the family to increase savings, or to raise the standard of living in the basic items of food, clothing, and shelter, or to expand its purchases of other goods and services. The aggressive marketer can influence the direction these discretionary desires may take.

EXHIBIT III

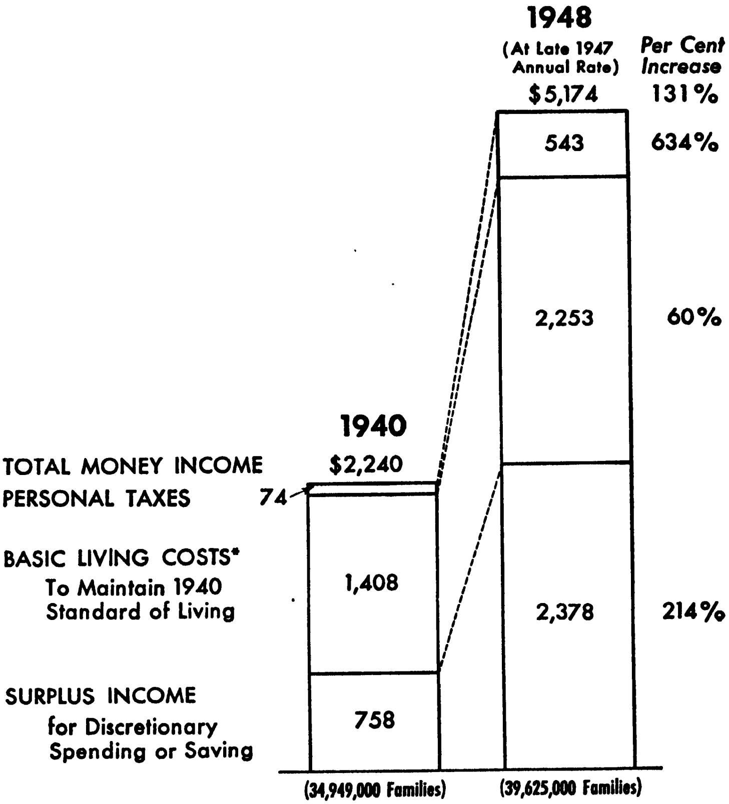
AGGREGATE INCREASE IN CONSUMER PURCHASING POWER, 1940–1948



* Food, clothing, housing, and household operation; an increase of 60% in consumer prices from 1940 to 1948 and an increase of 13½% in number of families result in an 82% increase in total expenditure required to maintain a 1940 basic standard of living.

EXHIBIT IV

INCREASE IN AVERAGE FAMILY PURCHASING POWER, 1940–1948



* Food, clothing, housing, and household operation; an increase of 60% in consumer prices from 1940 to 1948 means an increase of 60% in expenditures for these items to maintain the 1940 average basic standard of living for the family.

Differences from World War I Aftermath

The prophets of depression for early 1947 missed the profits of the high level of business in 1947 largely because their sights were set on World War I and the break in 1920.

Historically, we were in the spring of 1947 at the same point after the end of the war as in the spring of 1920 when one index or price after another started downward to drag us into the depression of 1921. While the business curves for the first 18 months after each war look somewhat the same, there are two points of essential difference having to do with the all-important factor of purchasing power:

Exhibit V

Comparison of Disposable Income and Savings after Two Wars

	Year	Total	Per Capita
Index of real disposable income after taxes —corrected for consumer price changes			
World War I:			
Prewar	1913	100	100
Year of war-end	1918	111	105
Second year after war-end	1920	99 (minus 1% from 1913)	91 (minus 9% from 1913)
World War II:			
Prewar	1939	100	100
Year of war-end	1945	166	156
Second year after war-end	1947	157 (plus 57% from 1939)	144 (plus 44% from 1939)
Index of real individual savings—corrected for consumer price changes			
World War I:			
Prewar	1913	100	
Year of war-end	1918	102	
Second year after war-end	1920	98 (minus 2% from 1913)	
World War II:			
Prewar	1939	100	
Year of war-end	1945	204	
Second year after war-end	1947	205 (plus 105% from 1939)	

1. In 1920 the purchasing power of the aggregate disposable personal income after taxes and correction for consumer prices was actually 1% lower than in 1913 before the war. On a per capita basis it was 9% under 1913. In other words, the United States population in 1920 could buy less physical goods and services with its total income than the population could afford to buy seven years earlier in 1913. Is it any wonder that inventories of high-price goods backed up on shelves in 1920? (See Exhibits V, VI, and VII.)

In contrast with this, the purchasing power of the aggregate disposable personal income early in 1947 was 57% greater than in 1939 before World War II. On a per capita basis the ability to buy physical goods and services in 1947 was 44% greater than in 1939.

EXHIBIT VI

COMPARISON OF INCOME TRENDS FOR WORLD WAR II AND WORLD WAR I

	Population (July 1)	Disposable Income of Individuals after Taxes * (in billions)	Disposable Income Per Capita	Consumer Price Index (U.S. Dept. of Labor) 1935–1939 = 100	Real Disposable Income (in 1935–1939 dollars)	
					Total (in billions)	Per Capita
World War I:						
1913	97,226,814	$ 33.3	$ 342	70.7	$ 47.0	$482
1914	99,117,567	33.2	335	71.8	46.2	467
1915	100,549,013	35.4	352	72.5	48.8	486
1916	101,965,984	41.6	408	77.9	53.4	524
1917	103,265,913	50.0	484	91.6	54.6	528
1918	103,202,801	55.9	542	107.5	52.0	504
1919	104,512,110	63.5	608	124.5	51.0	488
1920	106,466,420	66.8	627	143.2	46.6	438
1921	108,541,489	52.8	486	127.7	41.3	381
1922	110,054,778	57.0	518	119.7	47.6	433
World War II:						
1939	130,879,718	70.2	536	99.4	70.6	539
1940	131,970,224	75.7	574	100.2	75.5	573
1941	133,202,873	92.0	691	105.2	87.5	657
1942	134,664,924	116.2	863	116.5	99.7	741
1943	136,497,049	131.6	964	123.6	106.5	780
1944	138,083,449	146.0	1,057	125.5	116.3	842
1945	139,585,518	150.7	1,080	128.4	117.4	841
1946	141,228,693	158.4	1,122	139.3	113.7	805
1947 †	142,672,762	174.0	1,220	157.1	110.8	777

* Figures for 1913–1922 from National Industrial Conference Board, *The Economic Almanac 1946–1947* (New York, The Board, 1946), p. 35; figures for 1939–1946 from "National Income and Product Statistics," Supplement to *Survey of Current Business*, July, 1947.

† As of January 1, 1947.

2. In 1920 the purchasing power of the aggregate accumulated savings of individuals corrected for consumer prices was actually 2% under the reserve buying power of individual savings in 1913.

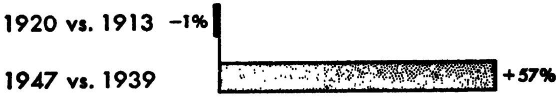
In contrast, the purchasing power of aggregate savings of individuals at the start of 1947 was 105% greater than in 1939—a reserve of buying power double the prewar level after correction for price increases. (See Exhibits VII and VIII.)

An interesting sidelight on the expectation that business in 1947 would follow the 1920–1921 pattern is the fact that only 27% of our population of

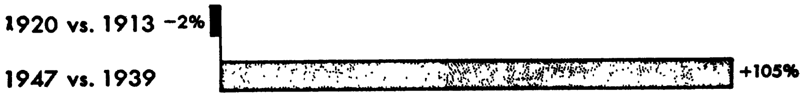
EXHIBIT VII

COMPARISON OF PURCHASING POWER OF INCOME AND SAVINGS AFTER TWO WARS

Real Disposable Income, After Taxes, Decreased 1% After World War I-Increased 75% After World War II



Purchasing Power of Aggregate Savings Decreased 2% After World War I-Increased 105% After World War II



	DISPOSABLE INCOME AFTER TAXES		AGGREGATE SAVINGS OF INDIVIDUALS	
	Actual (Billions)	Corrected for Consumer Price Index 1935-1939 = 100% (Billions)	Actual (Billions)	Corrected for Consumer Price Index 1935-1939 = 100% (Billions)
World War I				
1913	$33.3	$47.0	$12.7	$17.1
1920	66.8	46.6	24.1	16.8
% Change in Real Purchasing Power		−1%		−2%
World War II				
1939	$70.2	$70.6	$63.7	$64.0
1947	174.0	110.8	182.9	131.3
% Change in Real Purchasing Power		+57%		+105%

143,360,000 in April 1947 were old enough (19 years or more) in 1921 to have had much judgment-forming experience at that time. This same 27% must have been over 45 years old in 1947, however, and thus included most of the major policy-forming executives who early in 1947 were advising retraction of inventories, credit, or expansion plans. On the other hand, the 73% under 45 years old in 1947 represented the mass of the consumers, the young families who had not experienced 1921 and who went ahead with their buying plans backed up by a purchasing power far above prewar levels.

EXHIBIT VIII

COMPARISON OF TOTAL INDIVIDUAL SAVINGS FOR WORLD WAR I AND WORLD WAR II

(In millions of dollars)

World War I			World War II		
End of Year	Actual	Adjusted to 1935–1939 Dollars	End of Year	Actual	Adjusted to 1935–1939 Dollars
1913	$12,748	$17,100	1939	$ 63,685	$ 64,000
1914	13,477	18,800	1940	68,370	68,200
1915	14,732	20,300	1941	75,450	71,700
1916	16,275	20,900	1942	89,768	77,050
1917	17,434	19,000	1943	113,430	91,770
1918	18,846	17,500	1944	141,853	113,030
1919	21,493	17,300	1945	167,700	130,600
1920	24,094	16,800	1946	182,900	131,300
Total seven-year increase	$11,346	$ −300	Total seven-year increase	$119,215	$ 67,300
Per cent increase or decrease	+89%	−2%	Per cent increase or decrease	+188%	+105%

Note: Individual savings include: life insurance reserves, unpaid dividends and surplus, time deposits, United States savings bonds, savings and loan association assets, government pension and trust funds.

Source: National Industrial Conference Board, *The Economic Almanac 1946–1947* (New York, The Board, 1946).

RELATION OF DEBT TO INCOME AND SAVINGS

The expansion of consumer credit during 1947 has been viewed with alarm because in terms of dollars individual debt has reached totals above prewar years. Before drawing final conclusions on the gravity of this situation, however, let us take a look at the present relationship of individual debt, first, to individual savings and, second, to disposable personal income:

1. In 1929 the individual debt total of $49.3 billion represented 99% of the aggregate of individual savings. By 1940 the ratio of individual debt to savings had dropped to 63%. At the end of 1946 the ratio was only 27%. (See Exhibits IX, X and XI.)

EXHIBIT IX

RELATION OF INDIVIDUAL DEBT TO INDIVIDUAL SAVINGS, 1929–1947

Individual Debt (in billions of dollars)

End of Year	Individual Savings * (in millions of dollars)	Farm Mortgage	Noncorporate Urban Real Estate Mortgage	Consumer Short-Term Debt	Total Individual Debt	Consumer Short-Term Debt as % of Individual Savings	Total Individual Debt as % of Individual Savings
1929	$ 49,673	$9.6	$32.1	$ 7.6	$49.3	15%	99%
1930	51,376	9.4	33.1	6.8	49.3	13	96
1931	49,819	9.1	32.4	5.5	47.0	11	94
1932	47,454	8.5	30.5	4.1	43.1	9	91
1933	44,617	7.7	27.8	3.9	39.4	9	88
1934	46,869	7.6	27.1	4.4	39.1	9	83
1935	49,463	7.4	26.2	5.4	39.0	11	79
1936	52,247	7.2	25.8	6.8	39.8	13	76
1937	56,361	7.0	25.8	7.5	40.3	13	72
1938	59,402	6.8	26.0	7.1	39.9	12	67
1939	63,685	6.6	26.4	8.0	41.0	13	64
1940	68,370	6.5	27.3	9.1	42.9	13	63
1941	75,450	6.5	28.6	9.9	45.0	13	60
1942	89,768	6.1	28.0	6.5	40.6	7	45
1943	113,430	5.6	27.3	5.3	38.2	5	34
1944	141,853	5.3	27.2	5.8	38.3	4	27
1945	167,700	5.1	27.9	6.6	39.6	4	24
1946	182,900	5.3	33.5 est.	10.2	49.0 est.	5½	27

* National Industrial Conference Board, *The Economic Almanac 1946–1947* (New York, The Board, 1946), p. 34.

Source: *Survey of Current Business*, Vol. 27, No. 9 (September, 1947), p. 17.

Individual debt may have been overextended in 1929 at 99% of savings. But was it overextended in 1940 at 63% of savings? Taking the 1940 figure as the most conservative prewar relationship of debt to savings—it was the lowest ratio of the prewar years—let us see what expansion in debt could take place now without exceeding that conservative 1940 ratio.

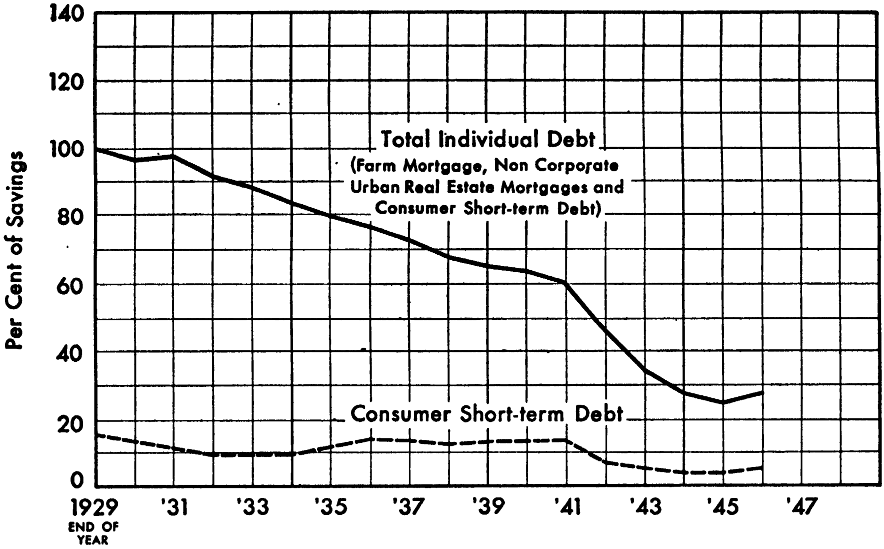
In 1940 consumer long-term debt, including farm and noncorporate urban real estate mortgages, represented a ratio of 49.4% of aggregate individual savings. At the end of 1946 the long-term debt of $38.8 billion represented only 21.2% of savings of $182.9 billion. Before passing the 1940 ratio these mortgage debts could be more than doubled to total $90.4 billion—a possible expansion of $51.6 billion additional.

Likewise, in short-term consumer credit, installment loans, and so forth, the total in 1940 represented 13.3% of savings. At the end of 1946 consumer credit totaled $10.2 billion or only 5.6% of savings. Before passing the 1940 ratio, consumer credit could increase by almost one-and-a-half times to a total of $24.3 billion—a possible expansion of $14.1 billion additional.

Together long-term debt and short-term individual debt have a potential expansion of $65.7 billion before exceeding the 1940 ratio to savings. (See Exhibit XII.)

EXHIBIT X

TREND OF CONSUMER DEBT IN RELATION TO INDIVIDUAL SAVINGS



2. Now let us look at the relationship of individual debt to disposable personal income. The usual guides to the soundness of a credit risk, beyond the integrity of the borrower, are the assets or savings and the income. The ratio of individual debt to savings has been shown. A very similar picture is shown by the relation of debt to disposable income. In 1940 total individual debt represented 56.7% of the total disposable income of individuals after taxes; mortgages represented 44.7% of income; and short-term consumer credit represented 12.0% of income. By early 1947 the ratio of debt to income had dropped to 28.9% or just about half of what it was in 1940. (See Exhibits XII and XIII.)

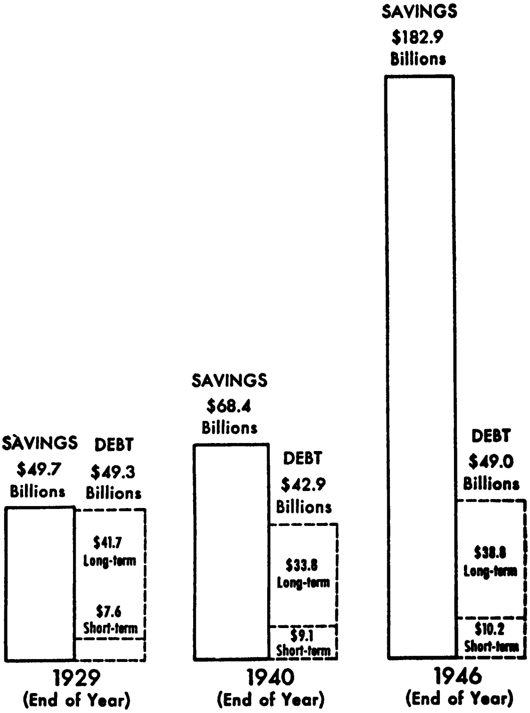
A total of $47.2 billion of debt could be added before exceeding the 1940 ratio of debt to disposable income: $37.0 billion could be added to mortgages, and $10.2 billion could be added to short-term consumer credit.

So, at the new levels of earnings and savings the outstanding individual debt looks very low. Both long-term and short-term credit could be doubled over present levels without exceeding the 1940 relationship to savings or disposable income. This fact can have far-reaching influences on the potential markets of 1948 and subsequent years.

Incidentally, we have heard much about the squeeze on savings during 1947. The current rate of savings has actually been higher than in the most prosperous prewar years, as is shown in Exhibit XIV.

EXHIBIT XI

DECREASE IN CONSUMER DEBT AS PERCENTAGE OF INDIVIDUAL SAVINGS, 1929–1946



RELATION OF DEBT TO SAVINGS			
Total Individual Debt	99% of Savings	63% of Savings	27% of Savings
Consumer Short-Term Debt	15% of Savings	13% of Savings	5½% of Savings

EXHIBIT XII

POSSIBLE EXPANSION IN CONSUMER DEBT BEFORE EQUALING 1940 RELATIONSHIP TO TOTAL INDIVIDUAL SAVINGS OR TO PERSONAL INCOME

(In billions of dollars)

Relation of Debt to Individual Savings

	1940 End of Year	1946 End of Year	Total Required to Equal 1940 Relationship	Potential Additional Consumer Credit
Total individual savings	$68.4 (100%)	$182.9	$182.9	
Mortgages *	33.8 (49.4)	38.8	90.4	$51.6
Consumer short-term debt †	9.1 (13.3)	10.2	24.3	14.1
Total consumer debt	$42.9 (62.7%)	$ 49.0	$114.7	$65.7

Relation of Debt to Disposable Personal Income

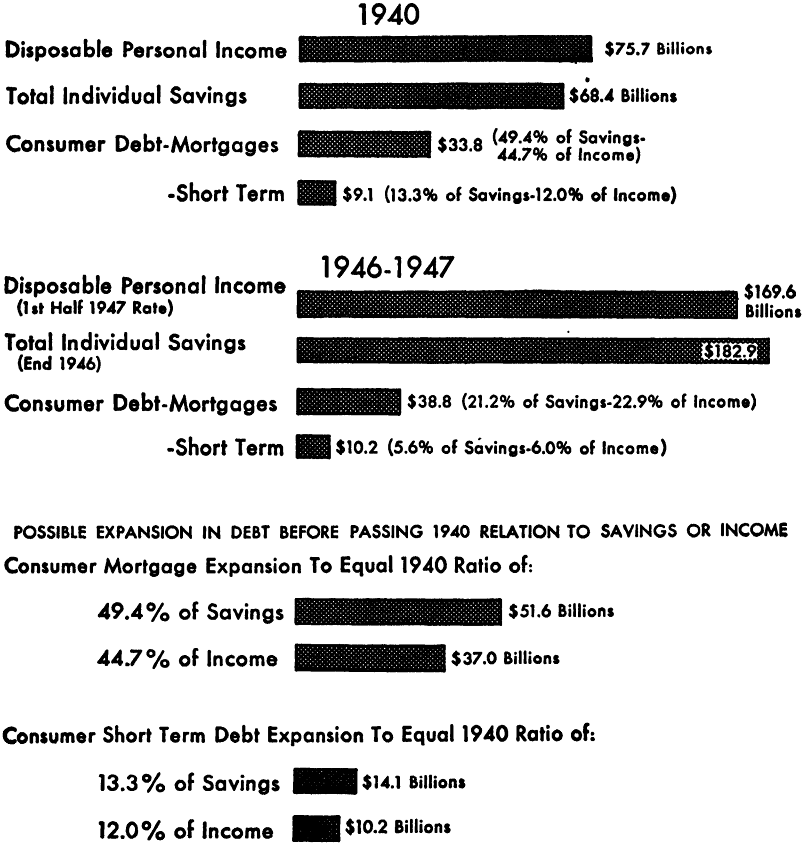
	1940	1947 (first half annual rate)	Total Required to Equal 1940 Relationship	Potential Additional Consumer Credit
Total disposable personal income	$75.7 (100%)	$169.6	$169.6	
Mortgages *	33.8 (44.7)	38.8	75.8	$37.0
Consumer short-term debt †	9.1 (12.0)	10.2	20.4	10.2
Total consumer debt	$42.9 (56.7%)	$ 49.0	$ 96.2	$47.2

* Includes total of farm mortgages and noncorporate urban real estate mortgages.

† Includes installment sale, installment cash loan, charge account sale, single payment loans, and service credit.

EXHIBIT XIII

CONSUMER DEBT IN RELATION TO SAVINGS AND INCOME



The actual level of savings put aside in 1947 was three times as large as in 1940 or 1929. It is only in comparison with the abnormal war years that savings now look small.

NEW KIND OF BUYERS' MARKET

We constantly have been warned during the last two years of a "boom and bust," which we are told will culminate in a sharp and serious depression when our production catches up with deferred demand and when there will once more be need to "sell" in a buyers' market.

It is altogether possible for such gloomy predictions to be correct—not, however, because production may catch up with demand, but rather because continued interference with the full flow of production may force prices temporarily to levels beyond even our vastly increased purchasing power. At this

EXHIBIT XIV

RELATIONSHIP OF PERSONAL SAVINGS TO DISPOSABLE INCOME, ANNUAL RATE, 1929, 1939, 1940, AND 1947

	Disposable Personal Income (in billions)	Personal Savings (in billions)	Savings as % of Disposable Income
1929	$ 82.5	$ 3.7	4.5%
1939	70.2	2.7	3.8
1940	75.7	3.7	4.9
1947 *	169.6	11.6	6.8

* Based on first half year.

rather critical stage anything that slows production or stands in the way of increased productivity of those employed can be dangerous—whether it be labor stoppages, management indecisions, legislative restrictions or uncertainties, or unjustified price increases.

Yes, it is possible for us to bungle ourselves back into depression and unemployment, but an analysis of our war-proven productive ability, our expanded labor force, and the vastly increased consumer market and higher standard of living that can be justified by fuller utilization of our productivity shows that any major depression in the next few years is neither necessary and inevitable nor as safely predictable as so many writers now seem to think.

I want to present a new concept of a buyers' market—a belief that a buyers' market need not be synonymous with depression, distress prices, and unemployment, but can be a sound condition of a prosperous economy with high levels of production and employment leading to the better standards of living that high productivity makes possible.

It takes about the level of wartime production—an annual rate of over $200 billion in terms of 1945 prices, or more than double our highest prewar levels—to provide employment for our present labor force at good wages. This means that once deferred demands are met, we cannot continue our present high level of employment unless we have a market for our production—a market for goods and services double the prewar size. We must not be blinded by present temporary shortages and fail to recognize that there is still a major job of selling and consumer education to be done to create a sufficient continuing demand for the goods and services we can produce.

Thus, when production has caught up with deferred demand, we shall indeed be facing a buyers' market; but it will be a buyers' market of far greater potentialities than any we experienced in the prewar period. It will be a buyers' market composed of millions of buyers looking for guidance in the spending of their increased discretionary spending power—looking for ways to improve their standards of living.

In July 1945 I presented before the Governors' Conference at Mackinac Island my study "57 Million Jobs—A Post-War Goal and Opportunity," which showed in detail how it would be possible and feasible for this nation to reach a gross national production level of $200 billion in peacetime (in terms of 1945 dollars), to provide employment for 57 million civilians, with income payments to individuals totaling $165 billion, and potentially to double the prewar levels of consumption without reaching excesses in our average standard of living. Subsequent events verified this prediction; in the first half of 1947 we did develop over 57 million civilian jobs, income payments to individuals at the annual rate of $197 billion, and a gross national product at the rate of $225 billion. But to turn this high rate of economic activity into a sustained period of prosperity will require intelligent and vigorous selling effort in a buyers' market.

CHANGES SINCE 1940

We must recognize that this buyers' market, in which we have to "sell" if we are to raise the levels of consumption high enough to sustain full production, is a very different market from the prewar market where most of our executives gained their experience. It will be necessary to raise our sights considerably to adjust for the changes since 1940. Here is a brief summary of some of these changes which are in addition to the increased productivity, increased consumer purchasing power, and likelihood of consumer debt expansion already discussed:

1. **Growth in Population and Number of Families.** It is estimated that by January 1, 1948, the United States population will have grown almost 14 million, from 131,669,275 in April 1940 to 145,400,000—an increase of 10%. The number of families will have increased by over 4½ million from 34,948,666 to 39,625,000—an increase of 13½%. We are now adding population at the rate of about 225,000 every month, which is like adding to our market every month a city the size of Richmond, Virginia; Omaha, Nebraska; or Syracuse, New York.

2. **Shift in Population from Rural to Metropolitan Areas and Regional Shifts.** Of some 3,073 counties in the United States only 242 are classed as metropolitan (dominated by a center with over 50,000 population). These 242 metropolitan counties, however, represented 51.6% of the total United States population in 1940. By 1943 these counties had grown to 54.4% of the population, and it is probable that they now represent about 56% of the population—a migration of over 6 million persons from rural to metropolitan areas where the pattern and standard of living are quite different. There have also been significant regional shifts in population that substantially change marketing patterns.

3. **Changing Make-up of the Population.** Between the census in April 1940 and the spring of 1948 there will have been 24½ million births, i.e., new people added to the market; 10½ million deaths, i.e., old customers lost forever; and 14 million marriages, i.e., new family formations, representing over one-third of all families.

4. **Influence of Veterans.** The United States population as of October 11, 1947, included some 13,994,000 male veterans whose purchasing habits and potential standard-of-living demands have been profoundly influenced by their wartime experiences and associations. Of the 12,652,000 male veterans clas-

sified as now in the labor force, 96% are employed. Most significantly, 92% of these employed veterans have found jobs in nonagricultural industries. The remaining 8% in agriculture compare with 20% of other employed males now in agriculture and with 28% of all employed males in agriculture in 1940. There have likewise been significant trends shown by the location of veterans. Some 16 states, mostly in the west but also in certain eastern industrial areas, have attracted well above their share of the veterans, while some 20 southern and midwestern states are considerably below average.

5. **Employment.** There are now nearly 12 million more civilians employed in nonagricultural employment than in 1940. This increase in nonagricultural employment means more workers per family in towns and cities. (See Exhibit XV.)

EXHIBIT XV

COMPARISON OF EMPLOYMENT, 1940 AND 1947

(In millions)

	Average 1940	Average 1947 *	Change since 1940
Agricultural employment	9.5	8.4	−1.1
Nonagricultural employment	38.0	49.6	+11.6
Total civilians employed	47.5	58.0	+10.5
Unemployed	8.1	2.2	−5.9
Total civilian labor force	55.6	60.2	+4.6

* Based on first ten months.

6. **Increase in Weekly Earnings of Nonagricultural Workers.** The New York Federal Reserve Board compiles an index of the weekly earnings in nonagricultural industries in the United States which shows that weekly earnings have increased 81% since before the war. (For wage earners the increase has been 91%, for clerical and professional workers 59%.) With 30% more people employed in nonagricultural work, this indicates an increase of 136% in money income to the aggregate of nonagricultural workers.

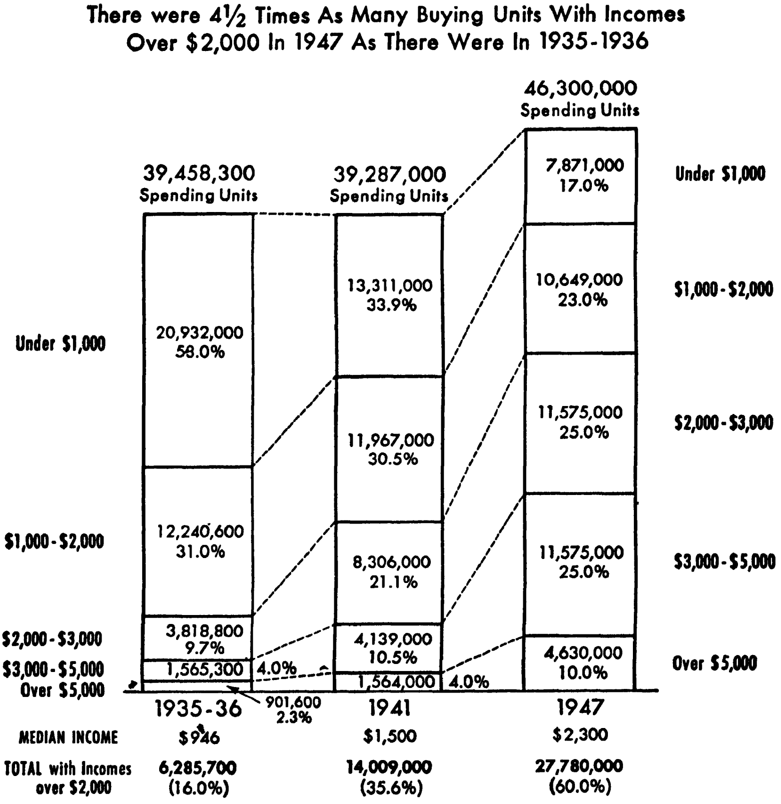
Of all the factors which represent a changed market since the prewar period, however, the most important to study is the influence of full employment and increased income payments to individuals upon the income groupings of families and single individuals. As we come into a buyers' market, the new market potentials indicated by the shifts upward in income groups of families are a vital key to increased sales.

SHIFTS OF FAMILY INCOME GROUPS

The great increase in national income payments and the addition of about 10,000,000 persons to the employment rolls have resulted in startling shifts in the income grouping of families and single individuals. The total of 27,780,000 consumer spending units (families and single individuals) in the United States early in 1947 with annual incomes over $2,000, for example, is 4½ times the 6,285,700 in 1935–1936 and nearly double the 14,009,000 there were in 1941. Even this does not show the whole shift since the Federal Reserve Board

Exhibit XVI

Income Distribution of Consumer Spending Units in the United States



Sources: Figures for 1935–1936 and 1941 are from U.S. Department of Labor Bulletin No. 822, *Family Spending and Saving in Wartime* (Washington, D.C., Government Printing Office, 1945), pp. 68, 71, 201; figures for 1946 are from "Survey of Consumer Finances," in *Federal Reserve Bulletin*, July, 1947, p. 791, which shows distribution of spending units in the first quarter of 1947 based on 1946 incomes.

study accounts for about $135 billion of income received by consumers, whereas by July 1947 personal income payments had reached an annual rate of $197 billion. This additional $62 billion of income would indicate even more extensive upward shifts than shown in the chart in Exhibit XVI.

A further analysis of shifts in income groups since before the war is important if these figures are to be used in measuring potential markets. So many market analysts and economists, when they are analyzing purchasing power, seem to overlook the effect of the shift upward in income groups by a large proportion of our families. They often point out the increased taxes and increased cost of living as compared with 1941 and show that those who were in a particular group in 1941 and who are still in that same income group are being seriously squeezed by increasing costs. This is, of course, very true for any segment of families where the income level has not risen since 1941.

For those families who have shifted to a higher income bracket, however, the increase in purchasing power for things other than the basic items of living becomes substantial because most of the unavoidable increased costs apply to their former standard of living rather than to the standard of living of the income group they have entered.

When the average family moves upward from one income bracket to another, it does not automatically take on the standard of living of the new income level. At the least, there is a decided lag before it does so. Part of this lag comes from the fact that the family is not yet educated to an acceptance of the higher standard of living of the group it has moved into. Another factor, particularly in the last year or so, has been actual inability of supply to meet new potential demands. As one example, take housing; it is obvious that the great majority of our families still live in the same homes that they occupied in 1941 despite changes in income. Improved housing has not been available and will not be fully available for some time to come. Furthermore, so large a share of our population own their own homes, acquired at prewar levels, that there is sure to be a further substantial lag before the majority of families move up their housing standards to conform to their new income levels. Housing may be an extreme example, but the principle is true of all items in the basic living costs.

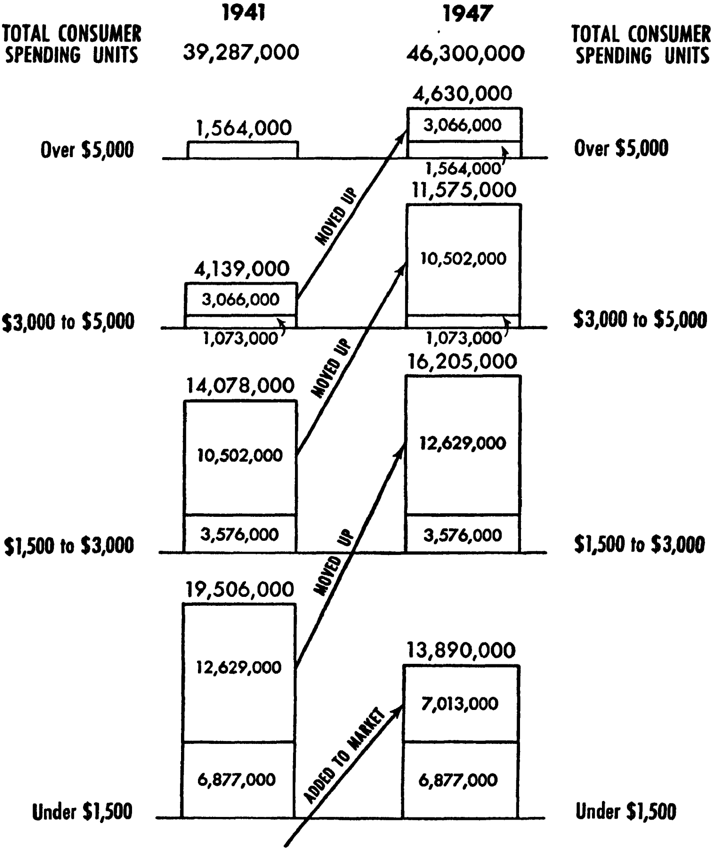
Therefore, in figuring how much of a family's increased income is left for discretionary spending after the inescapable price rises in basic living items have been absorbed, we need to take out only enough to cover the basic living costs applicable to the previous standard of living of the income group from which the family moved. Any other increases in spending for basic living items would be at the family's own discretion as to how far it wanted to go in stepping up to the higher standard of living of its new income group—that is, the result of deliberate decisions to buy better-quality food and clothing, to move into better housing, and so on. As such, these voluntary increases in spending for basic living items would be in strong competition with other discretionary spending for other types of goods and services.

Magnitude of Effect of Upward Shifts

A comparison of the government figures of consumer spending units in early 1947 with those of 1941, as portrayed in Exhibit XVII, indicates the probable shifts that have taken place. This chart obviously affords only a rough approximation; many families may have skipped entire income groups in their movement upward, whereas the chart is based on the assumption that the increase in number of families in each income bracket came only from the bracket immediately lower. For example, it is assumed that the 3,066,000 increase in the number of spending units with incomes over $5,000 in 1947 all came from the $3,000–$5,000 brackets in 1941. Subtracting this from the 4,139,000 units in that bracket in 1941 would leave an indicated 1,073,000 remaining in that group. Since that group has increased in total to 11,575,000, however, an indicated total of 10,502,000 must have moved up from the $1,500–$3,000 bracket, and so on.

Exhibit XVII

Upward Climb of Consumer Spending Units

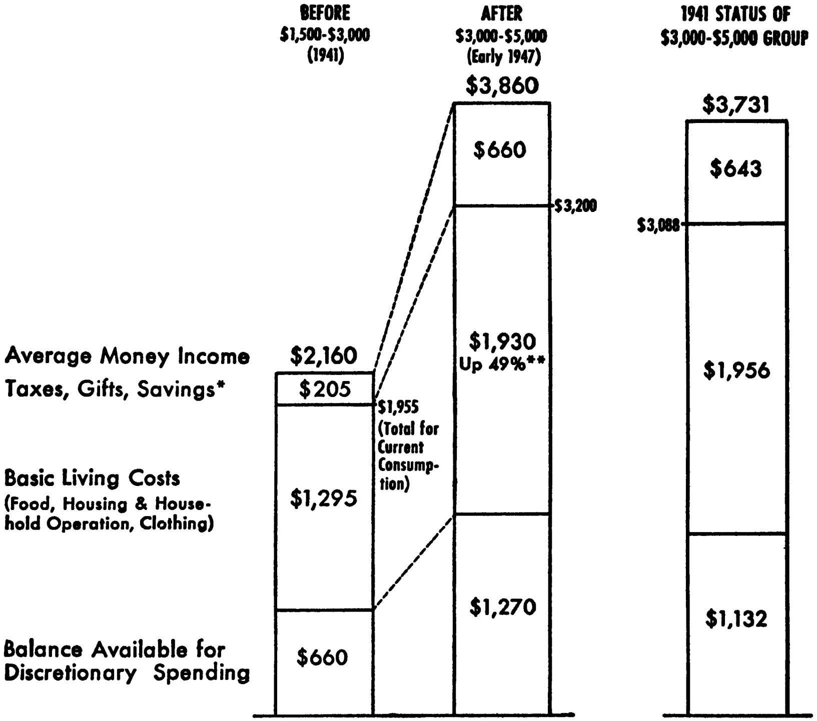


(In view of these great changes in the income distribution of families, the question frequently is raised whether people in the upper income groups have been sharing proportionately in the increased national income. For the years 1935–1936 the National Resources Committee compiled a table showing the share of aggregate income received by each tenth of the consumer units. The Federal Reserve Board in its recent survey compiled a similar table for 1946. A comparison shows that in 1935–1936 the upper tenth received 36% of the total income and in 1946 received 32%. To take a bigger slice, the top 30% of consumer units received 62% of the income in 1935–1936 and 59% in 1946. But despite this slight drop percentagewise, the aggregate income of the top

EXHIBIT XVIII

EFFECT OF INCOME SHIFT ON POTENTIAL MARKET

Example-Family Moving up From $1500-$3000 Group to $3000-$5000 Group
(Some 10½ Million Families Made This Upward Move-91% of Those Now in the $3000-5000 Group)



* $205 in first column is made up of federal income tax $5 and savings, gifts, other taxes $200; $660 in second column is made up of federal income tax $370 and savings, gifts, other taxes $290; $643 in the third column is made up of federal income tax $21 and savings, gifts, other taxes $622.

** Cost of Living Index (Consumer Price Index—U.S. Department of Labor) in June, 1947, was 157.1 compared with 105.2 in 1941, or an increase of 49%; prices are of course even higher in late 1947 than in June, but so is the personal income ($197 billion compared with $135 billion, according to the 1947 income distribution reported by the Federal Reserve Board).

30% increased from approximately $37 billion in 1935–1936 to approximately $80 billion in 1946. Furthermore, in 1935–1936 the top 30% represented all those with incomes over $1,540 per year, while in 1946 the top 30% represented all those with incomes over $3,110 per year or almost twice as much; this, again, is another way of indicating the great number of families that moved up into higher income groups.)

It seems clear, then, that a very large proportion of the families now in each income group have moved up to their present status since 1941 and that only a small proportion now in each group were in the same groups in 1941. This means that *most* United States families, having to absorb only the increases in the basic costs of living which apply to their prewar standards of living, enjoy *substantially increased* discretionary spending power that can be selectively used for raising their standards of living now and in the future.

The full effect of this rarely recognized factor can be illustrated by taking, as an example, a family typical of the 10½ million families moving from the $1,500–$3,000 income group in 1941 to the $3,000–$5,000 income group in 1947. (See Exhibit XVIII.) This family's income has increased from $2,160 to $3,860. The $660 available for taxes, gifts, and savings in the $3,000–$5,000 class would take care of the income tax increase for this family, now $370 rather than $5, and would still allow $290 for savings, gifts, and other taxes compared with $200 in 1941. The basic living costs (food, housing and household operation, and clothing) required to maintain the family on its regular prewar standard of living would come to $1,930 at 1947 prices compared with $1,295 in 1941. The balance available for discretionary spending would be $1,270 in 1947 compared with $660 in 1941, or almost twice as much.

It becomes obvious that the millions of families who have moved up into higher income groups since 1941 and who have not yet taken on the standards of living of the higher groups represent enormous new potential markets for all kinds of goods and services.

Potential Markets Projected

Two detailed studies by the United States Department of Labor covering family purchases in 1941 by income groups offer an opportunity to measure new potential markets that may result from the upward shift in income groups: *Family Spending and Saving in Wartime*, United States Department of Labor Bulletin No. 822; and *Rural Family Spending and Saving in Wartime*, United States Department of Agriculture Miscellaneous Publication No. 520.

Used together these two studies can be analyzed to show the average family rate of buying in terms of units and dollars for the various income groups in 1941 divided among urban, rural nonfarm, and rural farm. By applying these 1941 proven rates of demand in each income group to the present number of families and single individuals in each income group, as reported by the recent Federal Reserve Board study showing the income distribution of the 46.3 million consumer spending units, it is possible to project the current potential demand for many products.

Looking, for example, at the $2,000 to $3,000 income group in 1941 and using cross tabulation and combination of the facts reported in the two government surveys of 1941 spending, we see that the percentage of families buying a new car for this income group was 23% for urban families, 40% for rural nonfarm families, and 36% for rural farm families—an average of 26% of the 4,139,000 families and single individuals in this income group. This resulted in 1,076,200 new car buyers. The new government figures indicate that we now have a total of 11,575,000 consumer spending units with incomes of $3,000 to $5,000 and, further, that these families are financially able to spend as much or more for discretionary purchases as families in the same income group in 1941. At the 1941 rate of demand, 26%, this group would represent a potential of 3,009,500 new passenger car buyers annually. Similar analyses by other income groups result in an aggregate figure of maximum potential demand of 7.4 million new passenger cars annually or, assuming the same dollar expenditure rather than the same number of cars bought and allowing for a price increase over 1941 of 60%, a minimum sustained demand of about 4.6 million cars annually. (See Exhibit XIX.)

This calculation does not take into account the added deferred demand as a result of wartime stoppage of production. Nor does it take into account any increment in any particular income group in the desire for a new car as against any other possession; yet, historically, before the war the ratio of automobile possession per 100 families was constantly increasing in each income group.

Many estimates have been made of deferred demand for automobiles. A very minimum projection of past trends would indicate that by 1950 we could have expected a total of 35 million passenger car registrations had not the war interrupted. That figure is 5½ million more than the 1941 level, and it is 10 million more than our 1946 level; hence with no further scrapping it would require 2 million cars a year for 5 years to fill this deficit.

The increase in passenger car registration for the 11-year period from 1930 to 1941 averaged approximately 600,000 per year in spite of the fact that most of the 11-year period was characterized by depression, low incomes, and unemployment in the millions. Applying this minimum annual increment to the 9-year period 1941–1950 would show a minimum of 35 million cars required for the use of our population in 1950 without any allowance for the influence of full employment, substantially higher incomes, and growth in desirability and utility of the automobile. Passenger car registration in 1930 was approximately 23 million. An increase of 12 million, bringing the total to 35 million in 1950, would be just about in line with the increase in number of families in that 20-year period, since the census showed 29,905,000 families in 1930 and the latest census estimate for the end of 1950 is 41,200,000 families or an increase of 11,295,000 families.

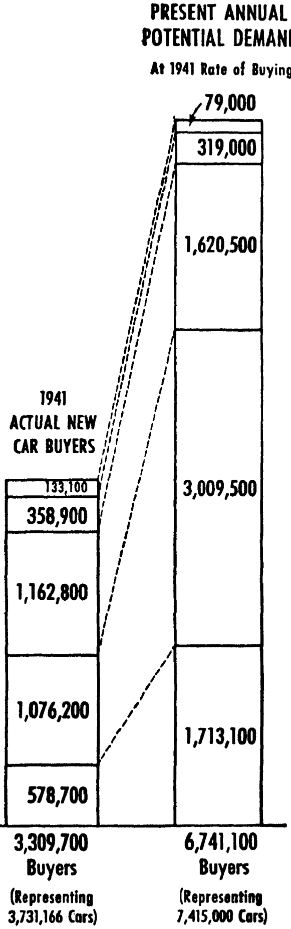
So, to the maximum potential demand of over 7 million new cars a year or the minimum sustained demand of 4½ million cars made feasible simply by our new pattern of income distribution, we can add a deferred demand of at least 2 million cars a year for 5 years. This could easily provide capacity operation and high levels of employment in the automobile industry for an extended period—*provided* this promising market is not seriously shrunken by further heavy increases in costs of production reflected in increased prices to the consumer.

This market analysis has shown that even with increased living costs most of those in the $3,000 to $5,000 income group, for example, have as much to spend for discretionary items like automobiles as had families in the similar income group in 1941; and that there are lots more families in that group now, which provides an enlarged potential market. Because new cars cost the consumer more than in 1941, however, it will be necessary for this group of consumers to set aside a larger amount of their discretionary spending money for cars if the same ratio of car buying is to be maintained, or to cut down the potential number of cars purchased to a point where the dollar expenditure per family is nearer what it was in 1941 for the group. That is why the increase of 60% over 1941 in delivered cost of a new car plus taxes may reduce

Exhibit XIX

Potential New Passenger Car Demand

MONEY INCOME GROUP	1941 FAMILIES*	1947 FAMILIES*	1941 DEMAND RATE**
Under $1,000	13,311,000	7,871,000	1%
$1,000-$2,000	11,967,000	10,649,000	3%
$2,000-$3,000	8,306,000	11,575,000	14%
$3,000-$5,000	4,139,000	11,575,000	26%
Over $5,000	1,564,000	4,630,000	37%
TOTAL	39,287,000	46,300,000	



* Consumer spending units (families and single individuals).

** New car buyers in 1941 as percentage of families in each income group.

Note: 7,415,000 cars at 1941 prices, adjusted for 60% price increase, would equal 4,630,000 cars.

the potential demand from 7.4 million cars to 4.6 million cars—unless the consumer can be convinced through advertising and sales promotion that the new car has enough added value to him to justify transferring some of his discretionary spending power from some other product or products.

Of course, manufacturers of the many other products with equally increased market opportunities will be faced with similar problems of realizing the *full* benefit of these increased market potentials if their costs and prices increase unreasonably. And competition for the consumers' discretionary money will be strong. The fact remains that, on any score, the potentials for 1948 are far greater than they were before the war.

Summary

There will be plenty of opportunity in 1948 for increased sales even in a buyers' market. A buyers' market implies that from among a variety of products and services, prices, and qualities the consumer can, at his own discretion, choose the things he desires most to maintain his standard of living within the limits of his purchasing power.

I have shown that both the per capita productivity and per capita real purchasing power now are much higher than in 1940; that in 1948 the consumers' surplus income for discretionary spending or saving may be over $94 billion or 3½ times the level of 1940; that in contrast to the decline in real purchasing power and savings after World War I, the early 1947 level was 57% higher than the 1939 level in real purchasing power and 105% higher in reserve purchasing power of savings; that both long-term and short-term consumer debt are abnormally low and could be expanded to double the present total without exceeding the 1940 relationship either to savings or disposable income; and that there have been some really startling shifts upward in the distribution of our families by income groups.

Further, I have shown that for those families which have moved up from one income group to another there is a substantial increase in discretionary spending power even after applying the present increased costs of living to those basic items which made up the family's former standard of living.

How consumers will apply this increased spending power is a matter of their own discretion. They could put it into additional savings, into increasing the quality or quantity of their basic living items, or into additional things that they may desire which they never have had before. Through the exercise of their discretion in spending they can reward those who can produce good values at prices they consider reasonable.

The real answer to inflation is production, and increased productivity is the key to maintaining or increasing present levels of earnings. The potential market for goods and services can be shown to be great enough to maintain even the high level of production reached in wartime, provided it is developed. But it will not develop automatically. The pattern of spending and living of those who move up from one income group cannot be expected automatically to fall into the same pattern of the group into which they have moved.

Some products or brands which are more aggressive will recognize this and "cash in" by changing the buying pattern in their favor. Others will sit back in fear, believing that a buyers' market means depression and retrenchment; they will not follow the pattern of the increased potentials. Thus those who are aggressive in their selling in this coming buyers' market have a chance to go well beyond the indicated increased potentials and to take for themselves a large part of what might have gone into increased sales for others.

The pattern of buying that will take shape in the coming buyers' market is largely in the hands of marketing executives. We have proved during the war our increased capacity to produce. We have an expanded labor force available for production. Under our free-enterprise system production creates an equal revenue with which to buy and consume what we can produce. In other words, the potentials are there. It is up to us to develop them.

MISCELLANEOUS STATISTICS ON INCOME AND EXPENDITURES

EXHIBIT 1

NATIONAL INCOME BY DISTRIBUTIVE SHARES, 1941–1946

(Millions of dollars)

	1941	1942	1943	1944	1945	1946
National income	103,834	136,486	168,262	182,260	182,808	178,204
Compensation of employees	64,280	84,689	109,102	121,184	122,872	116,763
Wages and salaries	61,708	81,681	105,537	116,944	117,551	111,113
Private	51,537	65,628	78,671	83,317	82,085	90,237
Military	1,862	6,285	14,478	20,782	22,438	8,010
Government civilian *	8,309	9,768	12,388	12,845	13,028	12,866
Supplements to wages and salaries	2,572	3,008	3,565	4,240	5,321	5,650
Employer contributions for social insurance	1,983	2,302	2,677	2,936	3,805	4,072
Other labor income	589	706	888	1,304	1,516	1,578
Income of unincorporated enterprises and inventory valuation adjustment	16,504	22,724	25,951	27,690	30,165	34,951
Business and professional	9,566	12,112	14,128	15,310	16,700	19,738
Income of unincorporated enterprises	10,210	12,464	14,266	15,369	16,754	21,046
Inventory valuation adjustment	−644	−352	−138	−59	−54	−1,308
Farm †	6,938	10,612	11,823	12,380	13,465	15,213
Rental income of persons	4,322	5,371	6,150	6,693	6,952	6,865
Corporate profits and inventory valuation adjustment	14,615	19,824	23,692	23,486	19,689	16,451
Corporate profits before tax	17,232	21,098	24,516	23,841	20,222	21,140
Corporate profits tax liability	7,846	11,665	14,153	13,913	11,283	8,601
Corporate profits after tax	9,386	9,433	10,363	9,928	8,939	12,539
Dividends	4,465	4,297	4,477	4,689	4,765	5,614
Undistributed profits	4,921	5,136	5,886	5,239	4,174	6,925
Inventory valuation adjustment	−2,617	−1,274	−824	−355	−533	−4,689
Net interest	4,113	3,878	3,367	3,207	3,130	3,174

* Includes the pay of employees of government enterprises and of permanent United States residents employed in the United States by foreign governments and international organizations.

† Inventory valuation adjustment data for farms are not available separately.

Source: *Survey of Current Business*, Supplement, July, 1947, p. 19.

EXHIBIT 2

GROSS NATIONAL PRODUCT OR EXPENDITURE, 1941–1946

(Millions of dollars)

	1941	1942	1943	1944	1945	1946
Gross National Product	125,294	159,628	192,573	210,551	213,120	203,679
Personal consumption expenditures	82,255	90,835	101,626	110,417	121,698	143,670
Durable goods	9,750	6,845	6,515	6,755	7,977	14,917
Nondurable goods	43,960	52,962	61,205	67,190	75,298	87,061
Services	28,545	31,028	33,906	36,472	38,423	41,692
Gross private domestic investment	17,211	9,330	4,591	5,658	9,058	24,582
New construction *	5,661	3,212	2,010	2,267	3,146	8,525
Producers' durable equipment	7,676	4,702	3,761	5,348	7,134	12,393
Change in business inventories	3,874	1,416	−1,180	−1,957	−1,222	3,664
Net foreign investment	1,124	−207	−2,245	−2,099	−754	4,773
Government purchases of goods and services	24,704	59,670	88,601	96,575	83,118	30,654
Federal	16,923	52,027	81,223	89,029	74,963	20,671
War †	13,794	49,567	80,384	88,638	76,172	21,293
Nonwar †	3,173	2,664	1,480	1,552	1,011	2,383
Less: Government sales ‡	44	204	641	1,161	2,220	3,005
State and local	7,781	7,643	7,378	7,546	8,155	9,983

* Includes construction expenditures for crude petroleum and natural gas drilling.

† The classification of purchases of goods and services into war and nonwar conforms, in general, to the Daily Treasury Statement classification of general and special account expenditures. War purchases include also that part of the capital formation of government enterprises which is attributable to their war activities. Government contributions to the National Service Life Insurance Fund are classified as war; all other government contributions for social insurance, as nonwar.

‡ Consists of sales to abroad and domestic sales of surplus consumption goods and materials.

Source: *Survey of Current Business*, Supplement, July, 1947, p. 19.

EXHIBIT 3

PERSONAL INCOME AND DISPOSITION OF INCOME, 1941–1946

(Millions of dollars)

	1941	1942	1943	1944	1945	1946
Personal income	95,308	122,159	149,432	164,915	171,590	177,217
Wage and salary receipts	60,907	80,515	103,489	114,901	115,202	109,225
Total employer disbursements	61,708	81,681	105,328	117,137	117,537	111,143
Less: Employee contributions for social insurance	801	1,166	1,839	2,236	2,335	1,918
Other labor income	589	706	888	1,304	1,516	1,578
Proprietors' and rental income	20,826	28,095	32,101	34,383	37,117	41,816
Dividends	4,465	4,297	4,477	4,689	4,765	5,614
Personal interest income	5,402	5,395	5,507	6,007	6,805	7,665
Transfer payments	3,119	3,151	2,970	3,631	6,185	11,319
Less: Personal tax and nontax payments	3,293	5,962	17,815	18,904	20,878	18,789
Federal	2,016	4,668	16,517	17,536	19,379	17,211
State and local	1,277	1,294	1,298	1,368	1,499	1,578
Equals: Disposable Personal Income	92,015	116,197	131,617	146,011	150,712	158,428
Less: Personal consumption expenditures	82,255	90,835	101,626	110,417	121,698	143,670
Equals: Personal saving	9,760	25,362	29,991	35,594	29,014	14,758

Source: *Survey of Current Business*, Supplement, July, 1947, p. 19.

EXHIBIT 4

RELATION OF GROSS NATIONAL PRODUCT, NATIONAL INCOME, AND PERSONAL INCOME, 1941–1946

(Millions of dollars)

	1941	1942	1943	1944	1945	1946
Gross National Product	125,294	159,628	192,573	210,551	213,120	203,679
Less: Capital consumption allowances	9,294	9,935	10,585	11,773	12,085	11,040
Depreciation charges	7,878	8,666	9,409	10,456	10,557	8,875
Accidental damage to fixed capital	273	484	399	374	384	404
Capital outlays charged to current expense	1,143	785	777	943	1,144	1,761
Equals: Net National Product	116,000	149,693	181,988	198,778	201,035	192,639
Plus: Subsidies minus current surplus of government enterprises	102	150	183	659	775	843
Less: Indirect business tax and nontax liability	11,296	11,813	12,685	14,029	15,339	16,851
Business transfer payments	502	494	504	549	564	528
Statistical discrepancy	470	1,050	720	2,599	3,099	−2,101
Equals: National Income	103,834	136,486	168,262	182,260	182,808	178,204
Less: Undistributed corporate profits	4,921	5,136	5,886	5,239	4,174	6,925
Corporate profits tax liability	7,846	11,665	14,153	13,913	11,283	8,601
Corporate inventory valuation adjustment	−2,617	−1,274	−824	−355	−533	−4,689
Contributions for social insurance	2,784	3,468	4,516	5,172	6,140	5,990
Excess of wage accruals over disbursements	0	0	209	−193	14	−30
Plus: Net interest paid by government	1,289	1,517	2,140	2,800	3,675	4,491
Government transfer payments	2,617	2,657	2,466	3,082	5,621	10,791
Business transfer payments	502	494	504	549	564	528
Equals: Personal Income	95,308	122,159	149,432	164,915	171,590	177,217

Source: *Survey of Current Business*, Supplement, July, 1947, p. 20.

EXHIBIT 5

PERSONAL CONSUMPTION EXPENDITURES BY TYPE OF PRODUCT, 1941–1946

(Millions of dollars)

Group	1941	1942	1943	1944	1945	1946
I. Food † and tobacco	26,476	32,842	38,090	41,564	46,740	55,086
1. Food purchased for off-premise consumption ‡ (ndc)	17,441	21,570	23,871	25,570	28,264	35,448
2. Purchased meals and beverages ‡	4,983	6,206	7,854	8,877	10,536	12,217
a. Retail, service, and amusement establishments (ndc)	4,440	5,706	7,423	8,651	10,000	§
b. Hotels (ndc)	502	585	753	873	966	§
c. Dining and buffet cars (ndc)	30	62	92	98	98	§
d. Schools and school fraternities (ndc)	109	118	123	120	125	§
e. Institutions, clubs, and industrial lunchrooms (ndc)	152	187	225	222	248	§
f. Tips (ndc)	174	224	292	338	386	§
g. Less: Nonconsumer purchases included in lines *a-f* (ndc)	424	676	1,054	1,425	1,287	§
3. Food furnished government (including military) and commercial employees, and withdrawn by nonfarm proprietors (ndc)	685	1,193	1,959	2,703	3,050	1,660
4. Food produced and consumed on farms (ndc)	1,294	1,573	1,897	1,905	2,021	2,350
5. Tobacco products and smoking supplies (ndc)	2,073	2,300	2,509	2,509	2,869	3,411
II. Clothing, accessories, and jewelry	10,483	13,176	16,279	17,972	20,054	22,163
1. Shoes and other footwear (ndc)	1,486	1,861	1,920	2,019	2,293	2,832
2. Shoe cleaning and repair (ndc)	144	179	256	256	256	293
3. Clothing and accessories except footwear (ndc)	7,085	8,508	10,574	11,675	13,210	15,530
4. Standard clothing issued to military personnel (ndc)	210	750	1,327	1,673	1,693	490
5. Fur storage and repair (s)	34	38	42	45	47	§
6. Cleaning, dyeing, pressing, alteration, storage, and repair of garments n. e. c. (in shops) (s)	479	549	604	645	671	767
7. Dressmakers and seamstresses (not in shops) (s)	36	42	43	53	59	§
8. Laundering in establishments (s)	374	420	444	462	484	564
9. Costume and dress suit rental (s)	3	4	3	3	4	§
10. Net purchases from second-hand clothing dealers (s)	4	5	6	6	6	§
11. Miscellaneous personal services (s)	11	13	16	17	19	§
12. Jewelry and watches (dc)	547	723	941	1,012	1,196	1,407
13. Watch, clock, and jewelry repairs (s)	70	84	103	106	116	§
III. Personal care	1,208	1,400	1,687	1,882	2,098	2,321
1. Toilet articles and preparations (ndc)	592	711	851	961	1,074	1,164
2. Barber shop services (s)	295	332	399	426	468	§
3. Beauty parlor services (s)	312	347	425	481	541	§
4. Baths and masseurs (s)	9	10	12	14	15	§
IV. Housing	9,863	10,578	11,085	11,661	12,137	12,690
1. Owner-occupied nonfarm dwellings—space-rental value ‖ (s)	4,655	5,088	5,471	5,945	6,404	6,862
2. Tenant-occupied nonfarm dwellings (including lodging houses)—space rent ‖ (s)	4,312	4,535	4,572	4,591	4,508	4,488
3. Rental value of farm houses (s)	658	702	755	820	889	978
4. Transient hotels and tourist cabins (s)	116	127	151	163	184	§
5. Clubs, schools, and institutions (s)	122	126	136	142	152	§
V. Household operation	11,724	12,235	12,559	13,317	14,484	18,009
1. Furniture (dc)	1,295	1,268	1,217	1,302	1,550	2,170
2. Floor coverings (dc)	513	535	588	553	540	841

* For footnotes see p. 54.

EXHIBIT 5 (*Continued*)

Group	1941	1942	1943	1944	1945	1946
3. Refrigerators, and washing and sewing machines (dc)	557	312				
4. Miscellaneous electrical appliances except radios (dc)	254	177	252	153	276	1,241
5. Cooking and portable heating equipment (dc)	354	211				
6. China, glassware, tableware, and utensils (dc)	633	670	633	671	847	1,326
7. Durable house furnishings, n. e. c. (dc)	546	602				
8. Products of custom establishments, n. e. c. (dc)	32	34	747	806	924	1,257
9. Writing equipment (dc)	77	48				
10. Net purchases from second-hand furniture and antique dealers (s)	19	19	19	20	20	§
11. Upholstery and furniture repair (s)	57	66	71	76	80	§
12. Rug, drapery, and mattress cleaning and repair (s)	26	30	32	35	35	§
13. Care of electrical equipment except radios and of stoves (s)	39	49	62	73	68	§
14. Semidurable house furnishings (ndc)	950	1,083	1,249	1,356	1,387	1,794
15. Lighting supplies (ndc)	123	134				
16. Cleaning and polishing preparations (ndc)	378	420	674	689	646	711
17. Miscellaneous household paper products (ndc)	81	108				
18. Stationery and writing supplies (ndc)	191	215	255	314	362	378
19. Fuel except gas and ice	1,707	1,946	2,112	2,123	2,225	2,248
a. Purchased (ndc)	1,601	1,835	1,993	1,997	2,103	2,127
b. Produced and consumed on farms (ndc)	106	111	119	126	122	121
20. Household utilities	1,851	1,962	2,032	2,155	2,274	2,395
a. Electricity (s)	965	1,016	1,043	1,123	1,198	1,275
b. Gas (s)	587	634	668	696	729	766
c. Water (s)	299	312	321	336	347	354
21. Telephone (s)	614	705	776	825	865	963
22. Telegraph, cable, and wireless (s)	16	18	21	22	23	§
23. Postage (s)	130	152	191	246	276	§
24. Express charges (s)	19	24	31	36	39	§
25. Moving expenses and warehousing (s)	90	109	125	148	160	§
26. Domestic service (excluding practical nurses)	1,118	1,285	1,416	1,660	1,828	1,835
a. Cash payments (s)	919	1,056	1,199	1,457	1,628	§
b. Value of meals furnished (s)	199	229	217	203	200	§
27. Fire and theft insurance on personal property—net payments ¶ (s)	28	26	28	29	31	§
28. Miscellaneous household operation services (s)	26	27	28	28	28	§
VI. Medical care and death expenses	3,961	4,501	5,038	5,441	5,754	6,447
1. Drug preparations and sundries (ndc)	725	849	1,008	1,069	1,146	1,335
2. Ophthalmic products and orthopedic appliances (dc)	226	255	299	324	343	395
3. Physicians (s)	991	1,139	1,213	1,293	1,339	
4. Dentists (s)	468	545	606	631	652	
5. Osteopathic physicians (s)	57	70	74	79	81	
6. Chiropractors (s)	39	45	48	51	52	
7. Chiropodists and podiatrists (s)	18	22	22	24	24	2,533
8. Private duty trained nurses ** (s)	58	62	67	75	80	
9. Practical nurses and midwives ** (s)	50	57	63	80	88	
10. Miscellaneous curative and healing professions (s)	19	22	24	25	25	
11. Privately controlled hospitals and sanitariums †† (s)	555	613	693	778	805	
12. Net payments to group hospitalization and health associations ¶ (s)	27	30	35	44	45	
13. Student fees for medical care (s)	2	2	2	2	2	1,320
14. Accident and health insurance—net payments ¶ (s)	141	164	182	211	250	
15. Mutual accident and sick benefit associations—net payments ¶ (s)	25	33	38	41	48	

EXHIBIT 5 (*Continued*)

Group	1941	1942	1943	1944	1945	1946
16. Funeral and burial service (s)	316	340	380	417	464	515
17. Cemeteries and crematories (s)	158	161	178	176	177	180
18. Monuments and tombstones (dc)	86	92	106	121	133	169
VII. Personal business	4,099	4,052	4,174	4,514	4,853	5,213
1. Miners' expenditures for explosives, lamps, and smithing (ndc)	14	18	63	68	77	113
2. Tools (dc)	51	56				
3. Theatrical employment agency fees (s)	12	14	18	20	20	§
4. Nontheatrical employment agency fees (s)	13	14	11	9	11	§
5. Net payments to labor unions ¶ (s)	178	211	265	261	241	§
6. Employees' dues and fees to professional associations (s)	4	6	6	6	6	§
7. Brokerage charges and interest, and investment counseling (s)	131	118	206	211	292	218
8. Trust services of banks (s)	53	51	54	58	62	§
9. Bank service charges for deposit accounts, check collection, and foreign exchange (s)	78	80	91	103	106	§
10. Safety-deposit box rental (s)	20	28	31	35	39	§
11. Money-order fees (s)	26	31	35	40	43	§
12. Services furnished without payment by financial intermediaries except insurance companies (s)	852	904	950	1,192	1,345	1,407
13. Expense of handling life insurance ‡‡	1,271	1,264	1,337	1,400	1,460	§
a. Life insurance companies (s)	1,222	1,213	1,284	1,336	1,394	§
b. Fraternal and assessment associations (s)	49	51	53	64	66	§
14. Legal services (s)	450	521	552	587	606	§
15. Interest on personal debt (s)	887	670	480	449	468	608
16. Classified advertisements (s)	29	31	36	33	34	§
17. Net purchases from pawnbrokers and miscellaneous second-hand stores (s)	14	15	16	17	18	§
18. Personal business services n. e. c. (s)	16	20	23	25	25	§
VIII. Transportation	8,241	5,170	5,229	5,510	6,320	10,862
1. User-operated transportation	6,777	3,127	2,437	2,568	3,281	7,627
a. New cars and net purchases of used cars (dc)	2,708	309	278	256	290	2,415
b. Tires and tubes (dc)	318	28	341	429	611	1,211
c. Parts and accessories (dc)	316	245				
d. Automobile repair, greasing, washing, parking, storage, and rental (s)	577	457	444	496	560	§
e. Gasoline and oil (ndc)	2,628	1,908	1,198	1,206	1,614	2,951
f. Bridge, tunnel, ferry, and road tolls (s)	57	44	34	35	41	§
g. Automobile insurance—net payments ¶ (s)	173	136	142	146	165	§
2. Purchased local transportation	985	1,309	1,647	1,730	1,750	1,880
a. Street and electric railway and local bus (s)	760	989	1,231	1,297	1,314	§
b. Taxicab—fares and tips (s)	177	261	353	370	372	§
c. Steam railway—commutation (s)	41	53	56	57	58	§
d. Ferry—foot passengers (s)	7	6	7	6	6	§
3. Purchased intercity transportation	409	643	1,032	1,089	1,146	1,163
a. Steam railway (excluding commutation) (s)	209	338	616	604	637	§
b. Sleeping and parlor car—fares and tips (s)	23	31	46	50	46	§
c. Intercity bus (s)	126	228	317	368	376	§
d. Air line (s)	23	22	24	32	54	§
e. Coastal and inland waterway (s)	23	17	18	23	21	§
f. Baggage transfer, carriage, storage, and excess charges (s)	5	7	11	12	12	§
4. Luggage (dc)	70	91	113	123	143	192
IX. Recreation	4,225	4,590	4,664	5,131	5,783	7,942
1. Admissions to specified spectator amusement	937	1,102	1,174	1,256	1,393	1,688
a. Motion picture theaters (s)	756	924	987	1,025	1,125	§
b. Legitimate theaters and opera (s)	40	48	68	82	84	§
c. Entertainments of nonprofit organizations, except athletics (s)	35	39	42	47	52	§
d. Professional baseball (s)	21	18	14	18	22	§

EXHIBIT 5 (*Continued*)

Group	1941	1942	1943	1944	1945	1946
e. Professional football (s)	3	2	2	3	4	§
f. Professional hockey (s)	4	4	3	4	5	§
g. Horse and dog race tracks (s)	13	12	11	14	19	§
h. College football (s)	39	31	26	32	43	§
i. Other amateur spectator sports (s)	22	20	16	25	30	§
j. Ticket brokers, mark-up on admissions (s)	2	2	3	4	6	§
k. Purchase of programs (s)	2	2	2	2	3	§
2. Pari-mutuel net receipts (s)	65	69	79	131	148	§
3. Nonvending coin machines—receipts minus payoff (s)	82	85	102	121	128	§
4. Specified commercial participant amusements	210	197	202	224	260	§
a. Billiard parlors and bowling alleys (s)	82	79	83	83	92	§
b. Dancing, riding, shooting, skating and swimming places (s)	33	33	36	48	54	§
c. Amusement devices and parks (s)	19	18	20	22	24	§
d. Daily fee golf courses—greens fees (s)	19	17	16	20	22	§
e. Golf instruction, club rental, and caddy fees (s)	45	43	44	48	61	§
f. Sightseeing busses and guides (s)	6	2	1	1	4	§
g. Private flying operations (s)	6	5	2	2	3	§
5. Informal recreation	2,367	2,550	2,471	2,633	2,962	§
a. Books and maps (dc)	247	265	346	423	468	474
b. Magazines, newspapers, and sheet music (ndc)	619	674	794	831	902	1,016
c. Book rental and repair (s)	4	5	6	6	7	§
d. Nondurable toys and sport supplies (ndc)	371	415	409	486	595	819
e. Wheel goods, durable toys, and sport equipment (dc)	254	260	229	265	323	598
f. Boats and pleasure aircraft (dc)	30	14	8	10	12	63
g. Boat and bicycle rental, storage, and repair (s)	9	9	9	9	10	§
h. Radios, phonographs, parts, and records (dc)	535	556	366	250	254	1,056
i. Pianos and other musical instruments (dc)	101	94				
j. Radio repair (s)	36	57	59	70	64	§
k. Photo developing and printing (s)	26	34	44	53	62	§
l. Photographic studios (s)	86	114	147	174	206	§
m. Collectors' net acquisitions of stamps and coins (s)	9	9	9	10	10	§
n. Hunting dog purchase and training, and sports guide service (s)	11	11	10	10	12	§
o. Veterinary service and purchase of pets (s)	29	33	35	36	37	§
6. Flowers, seeds, and potted plants (ndc)	247	269	315	391	457	576
7. Camp fees (s)	30	30	26	30	32	§
8. Clubs	203	205	217	236	280	332
a. Athletic and social—dues and fees (s)	74	71	73	78	104	§
b. School fraternities—dues and fees (s)	18	15	12	11	11	§
c. Fraternal, patriotic, and women's organizations except school and insurance—net payments (s)	102	110	122	137	154	§
d. Luncheon clubs (s)	9	9	10	10	11	§
9. Commercial amusements, n. e. c. (s)	84	83	78	109	123	§
X. Private education and research	692	815	961	931	853	975
1. Higher education †† (s)	283	316	363	372	362	§
2. Elementary and secondary schools †† (s)	202	215	237	244	246	§
3. Commercial, business, and trade schools—fees (s)	54	132	204	150	70	§
4. Correspondence schools—fees (s)	22	22	22	22	22	§
5. Other instruction (except athletics)—fees (s)	84	81	83	89	99	§
6. Foundation expenditures for education and research †† (s)	47	49	52	54	54	§

EXHIBIT 5 (*Continued*)

Group	1941	1942	1943	1944	1945	1946
XI. Religious and welfare activities	1,014	1,160	1,305	1,490	1,478	1,525
1. Religious bodies †† (s)	652	662	695	750	783	§
2. Social welfare and foreign relief agencies †† (s)	321	447	568	671	652	§
3. Museums and libraries †† (s)	16	16	16	16	16	§
4. Foundation expenditures (except education and research) †† (s)	16	16	17	18	18	§
5. Political organizations †† (s)	9	19	9	35	9	§
XII. Foreign travel and remittances—net	269	316	555	1,004	1,144	437
1. Foreign travel and remittances by United States residents	406	478	740	1,218	1,434	§
a. Payments to United States vessels (s)	13	4	3	3	5	§
b. Other foreign travel expenditures (s)	176	124	140	172	229	§
c. Expenditures by United States government personnel (military and civilian) (ndc)	77	251	417	822	944	120
d. Personal cash remittances to foreign countries (s)	140	99	180	221	256	§
2. Less: expenditures and remittances by foreigners	137	162	185	214	290	§
a. Expenditures in the United States (s)	94	122	140	169	196	§
b. Personal cash remittances to the United States (s)	43	40	45	45	94	§
Total personal consumption expenditures	82,255	90,835	101,626	110,417	121,698	143,670
Durable commodities	9,750	6,845	6,515	6,755	7,977	14,917
Nondurable commodities	43,960	52,962	61,205	67,190	75,298	87,061
Services	28,545	31,028	33,906	36,472	38,423	41,692

* Commodities and services purchased by government and business as well as consumers have been allocated between nonconsumer and consumer purchases, and only the latter are shown in this table with the exception of meals and beverages where the deductions made for nonconsumer purchases are indicated. Consumer nondurable commodities are designated *ndc* following group titles, durable commodities *dc*, and services *s*.

† Expenditures for alcoholic beverages—distilled spirits, wine, and beer—bought both in packaged form and by the drink are estimated as follows in millions of dollars: 1933—626, 1934—2,003, 1935—2,553, 1936—3,164, 1937—3,442, 1938—3,237, 1939—3,425, 1940—3,634, 1941—4,238, 1942—5,246, 1943—6,082, 1944—7,200, 1945—7,850, and 1946—8,770.

‡ Off-premise food estimates include fountain or lunch counter sales of post exchanges, ships' stores, meals sold by army messes, etc. The meals and beverages estimates, on the other hand, cover fountain sales of certain foods, especially packaged ice cream, for off-premise consumption.

§ Component service group estimates not shown separately are included in their respective subdivision and division totals.

‖ Space rent covers heating and plumbing facilities, lighting fixtures, storm windows and doors, window screens and screen doors, and window blinds or shades, but excludes other furnishings, equipment, and related services—furniture, stoves and ranges, refrigerators, repairs of furniture and appliances, fuel, electricity, etc. Purchases of excluded furnishings, equipment, and services are included in the appropriate commodity and service series. These housing estimates include housing furnished as part-compensation of nonfarm employees.

¶ Net payments are premiums minus claims paid, or in the case of labor unions and fraternal, patriotic, and women's organizations are gross payments minus cash benefits.

** Includes value of meals furnished.

†† These series are defined to include current expenditures of nonprofit organizations providing services principally to individuals, including depreciation but excluding relief payments within the United States.

‡‡ Total operating expenses of life insurance companies excluding payments to policyholders and expenses allocated to accident and health insurance.

Source: *Survey of Current Business*, Supplement, July, 1947, pp. 41–44.

II. INFLUENCE OF THE CONSUMER ON MARKETING

1. SOME NOTES ON CONSUMER BUYING MOTIVES

[One of the earliest approaches to the problem of consumer buying motives was made by Professor Melvin T. Copeland in his book *Principles of Merchandising*, from which the following excerpts are taken.]

To effect a sale, *two* parties are essential, a buyer and a seller. Each party, furthermore, must have a motive for participating in the transaction. The seller, in a business transaction, ordinarily aims to make a profit from each sale. That is his motive for selling. If he is offering obsolescent goods at less than cost, he, of course, does not realize a profit, but he seeks to make the sale on such terms as will minimize his losses. His motive is essentially the same under such exceptional circumstances as in an ordinary transaction where each sale does yield a profit. The individual consumer makes a purchase in order to satisfy his wants or those of his family. A buyer's motives are more varied and oftentimes less impelling than a seller's motives. Hence, under our competitive system of industry and trade, the initiative in sales transactions usually lies with the seller. If the seller is to continue to prosper, the sale must be mutually advantageous; the consumer must obtain the satisfaction that he is seeking. Otherwise, the reputation of the seller will be impaired and future patronage and prosperity imperiled.

Consumers' buying motives . . . dominate the merchandising plans of retail and wholesale merchants as well as those of manufacturers. A retailer, for example, who uses aggressive sales methods seeks to attract patronage by offering merchandise of the sort wanted by his potential customers. He is guided in making his purchases by what he believes he can sell most advantageously. A retailer's buying motives are predicated on the buying motives of his customers. His profits accrue from the expeditious sale of merchandise, not from goods that linger on his shelves; and the dispatch with which he can sell his merchandise is dependent upon the readiness of consumers to buy it, a readiness which can be accentuated by the stimulation of consumers' buying motives. A wholesale merchant, in turn, is receptive to the offerings of a manu-

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Source: Melvin T. Copeland, *Principles of Merchandising*, Chicago, Shaw, 1924.

facturer when the wholesaler is shown that the merchandise will have a ready sale to retailers and thence to consumers.

Practically every manufacturer, therefore, is confronted constantly with the following questions: What are the selling points of my product? What are the most effective sales arguments for my salesmen to use? What are the most promising appeals to use in advertising my product? To answer any of these questions satisfactorily, it is necessary to ask another: What are the motives that will lead consumers to buy the product? In other words, a "selling point" or a "sales argument" is effective only in so far as it succeeds in arousing a buying motive. The determination of the consumers' buying motives to which appeal should be made, consequently, is one of the keys to successful salesmanship and to effective advertising. This is the point whence sound merchandising plans are initiated.

The most prevalent malady that afflicts numerous sales and advertising departments is *sales egotism.* The chief executive of a manufacturing company, for example, his sales manager, and his advertising manager, thoroughly familiar with the product and its merits, inevitably tend to overestimate its salability. They recognize its good qualities with such great appreciation that they have difficulty in reminding themselves constantly that its merits are not equally apparent to those who are expected to purchase it. The necessity of keeping the consumer's point of view and his buying motives constantly in mind is a commonplace in salesmanship. Although almost universally recognized in principle, it proves to be far from easy to observe the rule in practice. It is to the neglect of this fundamental principle that the failure of numerous merchandising plans and much of the waste in marketing can be attributed.

Among the millions of consumers in the United States, some buy an article from one motive; other consumers buy the same commodity from other motives. Complete uniformity in wants and in buying motives never exists. Sales experience always shows, nevertheless, that one motive or group of motives tends to prevail in inducing consumers to purchase a particular article. The salesman and the advertising man can plan the performance of their tasks systematically, in fact, only because of the certainty with which they can count upon the response of large groups of consumers to their efforts to incite buying motives.

The number of buying motives that are operative among consumers is not large, and by observation and test it is possible to ascertain which buying motives are influential in merchandising any product. A successful salesman, consciously or unconsciously, determines the buying motives to which he can make effective appeal. The advertiser, likewise, consciously or unconsciously, must seek to arouse buying motives or patronage motives in the copy that he prepares. In working out the principles of merchandising, therefore, it is obvious that an analysis of consumers' buying motives must be made.

As in solving other merchandising problems, it is essential that the analysis of buying motives be based on actual conditions, not upon *a priori* reasoning. In order to ascertain the consumers' buying motives to which appeals most commonly are being directed at the present time, an examination was made of

936 advertisements in current periodicals (chiefly 1923 issues), including general magazines, women's magazines, national weeklies, and farm papers. . . .

In carrying on this study, the first differentiation of buying motives that became apparent was between primary motives and selective motives. A primary motive is one which imparts to consumers the major, initial impulse to purchase the kind of article offered for sale. In an advertisement of clocks, for example, in which the sales message centered on the point that such a clock is "one of the few truly permanent things that enter into home-making," the primary appeal was to the motive of *securing home comfort*—the desire to make the home more livable by the installation of an attractive clock. A selective motive, on the other hand, is one in which the aim is to divert the consumer's expenditure away from other brands of the same article. It does not recognize the fact that for most articles it is necessary to compete for the consumer's patronage, not only with other brands of the same article, but also with many other articles serving different purposes. The *economy in purchase*, or price, motive is an example of a motive that is selective. The average consumer does not purchase an article merely because it is cheap. First there must be a primary motive to purchase the article. Price then may come in to determine the choice between competing brands.

This differentiation is well illustrated by selling arguments for electric toasters. When a manufacturer of electric appliances advertises solely that his toasters are low in price, durable, or economical in the use of electricity, he is assuming that his task is to sell his brand of electric toasters to consumers who are at the point of making a selection between the various makes of toasters. He is overlooking the fact that probably a majority of potential purchasers of electric toasters have not had an impelling desire aroused for possessing such an appliance. Selective motives have a vital place in a merchandising plan, but the best results are not obtained by placing them ahead of the primary buying motives. Another appliance manufacturer who sets forth the handiness of an electric toaster or the delicious taste of hot toast, ready at just the proper moment at breakfast each morning, will sell many more toasters than are sold by the first manufacturer.

From the study of the advertisements covered in this survey, it was concluded that if the demand for any article is latent, appeals only to primary motives are appropriate. If the article is a new article or one for which the consumers have not felt the need, then the general objective in selling and advertising must be to arouse the desire for such an article before any attempt is made to influence brand selection; the consumer's expenditure must be diverted from other commodities or purposes. Even in the case of articles for which the demand is not latent, furthermore, it is unsafe to rely entirely upon selective motives.

. . . .

The fact that a buying motive is generally familiar to consumers is a strong reason for making a definite appeal to it; the more familiar consumers are with the motive, the more likely they are to be influenced by an appeal to that motive; it is sound practice, therefore, even in highly competitive industries, for a manufacturer to include appeals to major buying motives in his sales plans and in his advertisements and not to confine the appeals to those motives that are solely or even chiefly selective. Numerous instances among the advertisements examined indicated that the specific recognition by the advertiser in his copy of the existence of a major buying motive tends to strengthen rather than to weaken subsequent appeals to motives for brand selection. In personal salesmanship emphasis on consumers' primary buying motives likewise yields greater results than can be procured by stressing solely selective motives.

Another classification of the buying motives found in the 936 advertisements that were analyzed became apparent after the results had been tabulated. For merchandising purposes, this grouping is more basic than the distinction between primary and selective motives. In the fundamental classification of buying motives there are two groups: emotional and rational.

Emotional buying motives include *emulation*, *satisfaction of the appetite*, *pride of personal appearance*, *cleanliness*, *pleasure of recreation*, *securing home comfort*, and analogous motives. These motives have their origin in human instincts and emotions and represent impulsive or unreasoning promptings to action. Purchases are stimulated through these motives, not by an appeal to reason, but by arousing the desires of consumers to satisfy their instincts and emotions.

Rational buying motives are those which are aroused by appeals to reason. This group includes such motives as *dependability in use*, *durability*, *and economy in purchase*. When these appeals are used, it is expected that consumers will make their purchases only after reflection and the use of their powers of reason. When influenced by a rational motive, a consumer carefully weighs the advantages and disadvantages of the purchase before acting.[1]

[The list of buying motives [2] developed by Professor Copeland from this study of advertisements was as follows:]

Emotional Buying Motives

1. Distinctiveness
2. Emulation
3. Economical emulation
4. Pride of personal appearance
5. Pride in appearance of property
6. Social achievement
7. Proficiency
8. Expression of artistic taste
9. Happy selection of gifts
10. Ambition
11. Romantic instinct
12. Maintaining and preserving health
13. Cleanliness
14. Proper care of children
15. Satisfaction of the appetite
16. Pleasing the sense of taste
17. Securing personal comfort
18. Alleviation of laborious tasks
19. Security from danger
20. Pleasure of recreation
21. Entertainment
22. Obtaining opportunity for greater leisure
23. Securing home comfort

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[1] *Ibid.*, pp. 155–163.

[2] *Ibid.*, pp. 163–184.

Rational Buying Motives

24. Handiness
25. Efficiency in operation or use
26. Dependability in use
27. Dependability in quality
28. Reliability of auxiliary service
29. Durability
30. Enhancement of earnings
31. Enhancing productivity of property
32. Economy in use
33. Economy in purchase

[Some other lists of consumer motives developed by students of psychology, advertising, and salesmanship are shown below:]

DUNLAP [1]

1. Alimentary desires
2. Excretory desires
3. Desire for rest
4. Desire for activity
5. Desire for shelter
6. Amatory desires
7. Parental desires
8. Desire for preeminence
9. Desire for conformity

WISEMAN [2]

1. Profit
2. Admiration of opposite sex
3. Power
4. Self-preservation
5. Social admiration
6. Ease
7. Satisfaction (sensory implied)
8. Knowledge
9. Affection

BURTT [3]

1. Food instinct
2. Sex instinct
3. Parental instinct
4. Fear
5. Self-preservation or self-assertion
6. Play
7. Curiosity
8. Constructing
9. Bargain
10. Temperament

SNOW [4]

Natural Groups of Desires

1. To love, care for, sympathize with
2. To fear, fight, conceal, shelter
3. To eat, drink
4. To possess, own
5. To assert oneself, be submissive
6. To act, play, amuse, rest
7. To know
8. To imitate, to differ from
9. To be with others
10. To be clean
11. To save, spend

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[1] K. Dunlap, "The Foundations of Social Psychology," *Psychological Review*, Vol. 30 (1923), pp. 81, 102.

[2] Mark Wiseman, *The Anatomy of Advertising* (New York, Harper, 1942), p. 93.

[3] Harold E. Burtt, *Psychology of Advertising* (Boston, Houghton, Mifflin, 1938), pp. 76–94.

[4] H. J. Snow, *Psychology in Personal Selling* (Chicago, Shaw, 1926), pp. 48–59.

STARCH[1]

The First 10 of 44 Listed in Order of Importance

1. Appetite hunger
2. Love of offspring
3. Health
4. Sex attraction
5. Parental affection
6. Ambition
7. Pleasure
8. Bodily comfort
9. Possession
10. Approval by others

POFFENBERGER[2]

Basic Desires

1. To drink
2. To eat
3. Sex desire
4. Rest and comfort
5. To escape danger

6*a*. To succeed
  b. To be independent
  c. To have power
  d. To dominate others
7*a*. To conform
  b. To be different
8. Parental desires
9. To play
10*a*. To be with others
  b. To be alone
11*a*. To try the new
  b. To experience the familiar

A Few Important Acquired Desires

1. Cleanliness
2. Beauty
3. Economy
4. To be hospitable

NIXON[3]

Ten Important Primary Wants

1. Appetizing food
2. Thirst-quenching drink
3. Comfortable surroundings
4. Escape from danger and pain
5. Sex companionship
6. Means for promoting the welfare of others
7. Social approval
8. Superiority over others
9. Mastery over obstacles
10. Play

Twelve Important Secondary Wants (derived wants serve human wants indirectly)

1. Profit
2. Economy
3. Quality
4. Efficiency
5. Dependability
6. Style
7. Health
8. Beauty
9. Cleanliness
10. Convenience
11. Education
12. Protection

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[1] Daniel Starch, *Principles of Advertising* (Chicago, Shaw, 1923), pp. 272–273.

[2] Albert T. Poffenberger, *Psychology in Advertising* (New York, McGraw-Hill, 1932), pp. 50–85.

[3] H. K. Nixon, *Principles of Advertising* (New York, McGraw-Hill, 1937), pp. 75–76.

WYAND[1]

List of Instincts Which Wyand Found Most Lists Include

1. Instinct of self-preservation
2. Fear instinct
3. Sex instinct
4. Parental instinct
5. Acquisitive instinct
6. Gregarious instinct
7. Instinct of curiosity
8. Aggressive instinct

[Several students of the problem have suggested that sales and advertising executives should abandon the attempt to perfect a list of desires and approach the general problem of the explanation and prediction of human behavior in a different fashion. An early exponent of this point of view observed that often in using the traditional approach of listing motives, many people think they are explaining actions when they are really just deciding on a label or name for a blank space in their knowledge.[2] Kornhauser concludes that the useful way for a businessman to study "instincts" or desires is by investigating factors present in the total makeup of the individual concerned and the total stimulating situation in which he finds himself. A recent writer on the subject expresses this idea by means of a formula: $R = f(S,I)$. In this formula "any given *reaction* (R) is a function of a complex pattern of relationships between factors making up the environmental *situation* (S) and the individual (I) as they exist at the moment of reaction."[3] Accuracy of prediction of R depends on analysis of S and I. Under this theory motives do not lend themselves to an elementary listing but instead "are complex patterns of factors including such things as capacities, skills, habits, attitudes, knowledge, physiological state, and personality traits."[4] Moreover, even when much is known about a *motive* in a given case, prediction is possible only in the light of information about S.

When viewed this way, the problem of predicting human behavior shifts from the level of abstract, logical generalization and classification to the level of concrete empirical research. Of course, the businessman must deal with *groups* of individuals and must therefore generalize to some extent, but not, according to the thinking of those who support the conclusion described briefly in the above paragraph, to the extent of relying upon the list-of-motives approach. Businessmen, it is argued, should instead conduct experiments and surveys investigating S and I in order to predict reaction in a particular situation. The following quotation summarizes this point of view:]

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[1] Charles S. Wyand, *The Economics of Consumption* (New York, Macmillan, 1937), pp. 160–163.

[2] Arthur W. Kornhauser, "The Motives-in-Industry Problem," *Annals of the American Academy of Political and Social Science*, September, 1923, pp. 105–116.

[3] Douglas McGregor, "Motives as a Tool of Market Research," *Harvard Business Review*, Vol. XIX, No. 1 (Autumn, 1940), p. 45.

[4] *Ibid.*

For example, instead of asking a customer "Why did you switch from brand X to brand Y the last time you bought coffee," we need to determine by investigation possible *S* and *I* factors which may have been instrumental (e.g., "deals" and particular advertising campaigns, possible attitudes, and other subjective "reasons"), and then give her the opportunity to say whether any of these things were influential. The more exhaustive our list of possible "causes" (and devising such a list involves actual field research in any given instance), the more likely we are to cover those that operated in her particular case. While she may have considerable difficulty in thinking unaided of the things that influenced her, when these *S* and *I* factors are verbalized for her she has much less difficulty in recognizing any that may have been important. Hence, we reduce the amount of rationalization, and in so doing we increase the accuracy of our results. And if our list of alternatives is reasonably exhaustive, we need have little fear of suggesting the answer to her. The same thing is true of those attitudes which are consciously held but not consciously associated with the behavior in question. And the check on the shrewdness of the advertiser's guesses is quite objective: "Do those that have switched and those that have not switched (for example) differ significantly with respect to these factors?" If they do, he has guessed correctly. If they do not, his analysis is inadequate or misdirected, and he must renew his search.[1]

SOME NOTES ON INDUSTRIAL BUYING

A. THE PURCHASING PROCEDURE

INTRODUCTORY

To accomplish the act of purchasing, certain steps follow in natural sequence and are common to practically all purchasing operations. The process is set in motion by a requisition, which states a requirement and provides the authorization for making a purchase. This may refer to a special item or material for a particular purpose or manufacturing order; or, on standard materials in regular use, it may come from the storeroom, where predetermined minimum quantities of such standard materials are kept on hand; or it may represent the requirements of an operating schedule planned and projected to cover a period of time in advance. After the requisition has been received and checked in the purchasing department, it may be necessary to send out inquiries and receive quotations, or to negotiate otherwise with possible suppliers. In any case, it will be necessary to select a vendor and to place a purchase order. Copies of this purchase order are distributed to the various departments concerned with receiving, using, and accounting for the material, and provision is made for following up or expediting the delivery of the material as required.

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[1] *Ibid.*, p. 50.

Source: *N.A.P.A. Handbook of Purchasing Policies and Procedures* (New York, National Association of Purchasing Agents, 1942), Vol. II, Chap. 9, pp. 1–18. Reprinted by permission.

This chapter presents a record of actual practice in 252 representative purchasing departments, buying for large, medium-size and small companies in a diversified group of industries, with respect to such procedure. The further steps of receiving deliveries and checking invoices, and an analysis of the forms used in purchasing, are discussed in succeeding chapters.

ORIGINATING THE PURCHASE REQUISITION

The need for materials, supplies and equipment, expressed in the purchase requisition, rarely originates in the purchasing department. Table 140, which summarizes prevailing practice, mentions the purchasing agent in only 1% of all the cases as the source of the requisition. The function of purchasing is not to state a need, but to fulfill that need through procurement.

Nor is it generally considered a function of executive management to originate a requisition. Management appears as a factor in only 3% of the cases. One large organization reports that the Board of Directors initiates the requests for purchasing large amounts of raw materials. Where important investments in materials represent major decisions of company policy or may become the cause of possible losses, it is obvious that special safeguards should be set up. But this is ordinarily accomplished by establishing a limit to the size of orders which may be handled in the regular course, or by requiring certain additional authorizations before a purchase order is issued against the requisition. Certainly any prudent purchasing officer will consult with financial and management executives before committing the company to extraordinary expenditures. Another special case is presented by a large organization whose principal raw materials are produced in the company's own mining operations. Here the Director of Purchases has the additional title of Director of Raw Materials, and has the responsibility of scheduling mining operations so as to keep those supplies in balance with the manufacturing program.

In the majority of companies, regardless of size, purchase requisitions originate with the heads of departments where the materials are to be used. This practice obtains in 63% of the companies reporting, which emphasizes the essential nature of the requisition as a reflection of the operating schedule or program of the company. As that program goes from the planning stage into actual operation, the detailed material needs appear at the point of use.

Two other facts are worth noting in Table 140. The superintendent and the production department together are responsible for issuing the requisitions in one-third of the smaller companies, but this responsibility grows progressively less as the size of the organization increases. Among the large companies, the superintendent issues requisitions in only 2% of the cases. Requisitions originating in the production department, in this analysis, may reasonably be regarded as merely a special case of requisitioning by a department head, and would strengthen the conclusion stated in the preceding paragraph. Using this method of classification, requisitions are seen to originate in the using department in 71% of the companies.

The second observation is that the storeroom, which is not a factor at all in the smaller companies, becomes increasingly important as the originator of purchase requisitions in the larger organizations, and performs this function in 23% of the large companies. This is due in part to the practice of establishing standard stock quantities, with maximum and minimum limits, on items in regular use; purchase requisitions are then issued by the stores department when the minimum stock or ordering point is reached.

TABLE 140

ORIGINATION OF PURCHASE REQUISITIONS

Size of Organization	Department Heads	Storeroom	Production Department	Superintendent	Executive	Purchasing Agent
Small	66%	....	17%	17%		
Medium	56	21%	9	8	5%	1%
Large	64	23	8	2	2	1
All reporting	62	21	9	4	3	1

Many companies use an intermediate step, by which the using department requisitions its needs from the stores department. Then, if these materials are not available from supplies on hand, or if the issue of the materials should deplete the stock to a point where additional purchases are indicated, the stores department in turn issues a purchase requisition to the purchasing department. There is a distinction, in this case, between the requisition on stores and the purchase requisition.

It should also be noted that . . . the stores department frequently functions as a part of the purchasing department or of the production department. This would have some bearing on the interpretation of the figures shown in the table.

LIMITATIONS ON AMOUNT OF REQUISITION

Although the purchase requisition indicates a specific need of the company in carrying on its business, there is quite general recognition of the necessity for some sort of control over these requests and the consequent expenditures, other than the discretion of the requisitioning department and the purchasing agent. A plan that is commonly used to secure such control over routine expenditures is to place a limit on the quantity or value of individual purchase requisitions. Within these limits, the request for material and its purchase may be handled as a matter of routine procedure; beyond these limits the proposed purchase is subject to special consideration and requires the special authorization of some other executive or official of the company, since it is deemed to come within the realm of policy rather than of ordinary procedure. This is particularly true when purchases of equipment or other capital expenditures are contemplated.

This simple device has been subject to abuse, particularly in the field of governmental purchasing, where the limits are set by statute rather than as an expression of executive policy. There are many cases on record where such a regulation has been evaded by dividing a large order into two or more smaller requisitions, each being individually within the stated limitation though the total value is clearly in excess of the stipulated amount. Similarly, a large piece of equipment may be broken down into its component parts for the purpose of requisitioning and ordering. The same incentive or temptation to evade a stated policy does not ordinarily exist in private business.

The limits placed on the amount or value of a purchase requisition vary widely between individual companies using this plan, and there is no particular significance in reciting a list of such permitted values. It is worth noting, however, that the practice is more generally applied to requisitions for capital expenditures than on maintenance supplies and operating materials, and that when both types of purchases are subjected to this sort of control, the allowable value is generally more liberal in respect to maintenance and operating items.

Illustrating the first point is Table 141, which shows that among the companies contributing to this study, 55% have placed a limit on the value of requisitions for capital purchases, whereas only 42% have limited the value of requisitions for maintenance and operating supplies, before further executive approval is required. Illustrating the second point is the report of a large oil company, citing the rule that executive authorization must be secured for purchases of capital equipment in excess of $200, whereas expenditures for the maintenance and operation of existing capital equipment may go as high as $1,000 without similar review and special approval.

TABLE 141

PRACTICE AS TO LIMITING THE PERMITTED VALUE OF REQUISITIONS

	A. On Maintenance and Operating Expenditures		*B*. On Capital Expenditures	
Size of Organization	Yes	No	Yes	No
Small	46%	54%	57%	43%
Medium	40	60	49	51
Large	40	60	57	43
All reporting	42	58	55	45

APPROVALS REQUIRED ON REQUISITIONS

A control procedure, which is at the same time more flexible and more completely effective in subjecting all requisitions to review before they are sent to the purchasing department for action, is to require the signature or authorization of some one other than the originator in order to make the requisition valid. This is the practice in 41% of the companies reporting. It need not be a cumbersome or time-consuming process, and is frequently accomplished merely by routing the requisition up through the department, in the regular line of authority, on its way to the purchasing office. It serves the additional purpose of keeping superintendents and management officials informed as to what is going on.

In 59% of the companies, requisitions are sent directly to the purchasing department by the originator, without further approval. This procedure prevails in 80% of the small companies, 65% of the medium-size companies, and 55% of the large companies. The exceptionally large percentage reported in the small company bracket is understandable, not only because of the generally simpler organization and routine, but also because the purchasing agent in a small business normally has a closer direct contact with the managing officials. Although formal authorization and signature by such officials may not be required in respect to the individual purchase, those in charge of plans and policy for the small company usually have a more detailed familiarity with immediate requirements and maintain a sufficiently close contact with the purchasing agent to know when important expenditures are contemplated.

In 103 companies, 41% of those reporting, the requisition does not go directly to the purchasing department, but is routed first to some other office or department before it can be accepted as the basis for making a purchase. Table 142 presents an analysis of these required approvals. In a majority of cases, it is a responsibility of the superintendent or manager, following a normal line of authority from the department head as originator of the requisition to his immediate superior for authorization. Other important factors include the

TABLE 142

EXTENT TO WHICH REQUISITIONS ARE SENT FIRST TO ANOTHER DEPARTMENT OR OFFICIAL

Size of Organization	Superintendent or Manager	Various Other Officials	Storeroom	Accounting or Budget Department
Small	10.3%	10.3%	.....	20.5%
Medium	26.7	8.2	2.9%	3.3
Large	23	7.8	6.2	4.1
All reporting	23.4	7.4	5.3	4.9

stores department, where a requisition might be stopped short of a purchase because of available stocks on hand; the accounting or budget department, having general supervision over all financial commitments; and various other officials, from the president on down. The latter classification includes some committee approvals. For example, in one company, requisitions are considered at the weekly meeting of a production control committee before they are passed along to the purchasing department.

One important and logical purpose of review and approval of the requisition before translating it into an actual purchase is the matter of budgetary control. This is indicated to some extent in the general summary of company practices above. In answer to a specific question on this point, only 22% of all the companies reported that such budget control is exercised in their organizations, while an additional 6% in the medium and large companies secure budget approval of requisitions in some cases. A large majority, 72%, use no such application of budget control.

These percentages represent industrial practice. Among governmental units, public institutions, universities and similar organizations operating on definite departmental appropriations for supplies and expenses, it is the usual and necessary procedure to check requisitions against available budget balances before making a purchase commitment.

TABLE 143

EXTENT TO WHICH REQUISITIONS ARE APPROVED FIRST FOR BUDGET CONTROL BY TREASURER OR OTHER OFFICER

Size of Organization	Yes	No	Sometimes
Small	40%	60%	
Medium	23	72	5%
Large	23	71	6
All reporting	22	72	6

CHECKING THE REQUISITION

When the requisition is received in the purchasing department, it is checked by the purchasing staff regardless of previous approvals. There is practically unanimous agreement that such a check is a responsibility of the purchasing department, to the end that the proper quality may be ordered, in the proper quantity and at the proper time . . . or that material on hand may be utilized rather than making a new purchase. From the standpoint of general company operation, this is one of the basic functions of the department.

It may be inferred that as a result of this check, the purchase order may differ in some details from the requisition against which it is issued, as to quantities, for example, or even as to the material ordered; or that the requisition may be returned for a revision before the purchase is made. This conclusion is borne out by extensive studies of these corresponding forms in specific transactions. It emphasizes the fact that the requisition is essentially an intra-company form, indicating a need and providing the authority to purchase, whereas the actual procurement, establishing the relationship with the vendor and making the purchase contract, is a separate step and is accomplished with another form—the purchase order issued by the purchasing department.

The principal factors on the requisition, to be checked by the purchasing department, are:

1. Quantity, checked as to reasonableness of the request in relation to the need, as to economical ordering or manufacturing quantities, as to inventory policy, and as to market conditions. This check is made in 88% of the reporting companies.

2. Description of material wanted, checked for accuracy, conformity with company standards, and proper and adequate ordering information, so that suitable material may be procured. This check is made in 86% of the companies, and is discussed further in the succeeding section.

3. Time of delivery, checked against the need and against the normal period required for production and shipment by the supplier, and in transit. The purpose of this check is to help the purchasing department in arranging to have the material on hand when needed. In more specific terms, it tends to eliminate unnecessary rush orders, expensive means of fast delivery, and unreasonable demands for service by suppliers. It helps the buyer to cooperate with the supplier's production schedule, to establish a definite delivery date in the stated terms of the purchase order, to make arrangements for special service as required, and to set up a schedule for follow-up and expediting to see that the delivery is made on time. This check is made in 85% of the companies.

4. Previous purchases of the item, checked to indicate the rate of consumption and experience with various potential suppliers. This practice . . . is shown to be used by 71% of the companies considered in the earlier study. There is a close correlation with that figure among the companies reporting in the present study, for 77% of this group make the same check.

5. Checking against surplus or obsolete stocks to explore the possibility of utilizing similar materials on hand instead of making a further expenditure for new materials. This is an important factor in reducing losses from preventable waste. The check is made in 67% of the companies.

To take care of this last item, many of the large companies have well organized and equipped reclamation or salvage departments, which have proved to be a good investment. . . . Of the purchasing departments 88% are in charge of salvage disposal for their companies, a condition which places them in an excellent strategic position to arrange for the utilization of surplus and obsolete stocks whenever possible, rather than disposing of them outside of their own organization. Among the companies operating two or more plants, it is common practice to maintain a master list of standard and surplus stocks on hand at all plants, showing the amount and location of such stocks, so that a requisition may be filled by transfer or inter-plant sale of materials instead of by purchase from an outside supplier. Where the utilization of surplus stocks is a regular part of purchasing department policy, this practice is especially valuable.

Description of Material

Since the purpose of a purchase requisition is the procurement of a particular type of needed material, it is essential that such requests shall furnish the purchasing department with a complete and accurate description, so that there may be no doubt as to what is required for the intended purpose. This may be in the form of a written description, a standard form of brief specification, an identifying material or part number, or a reference to the previous purchase. Failure on the part of the requisitioner to make his request clear may result in delay while more specific information is obtained, or in losses due to the procurement of the wrong material. In a compact organization, operating a single plant, where all offices are under the same roof or in close proximity, the problem of securing additional information on questionable items is not too difficult. In any case, however, it entails additional and avoidable effort.

To have the requisition reach the purchasing department with an adequate ordering description of the needed material has been a constant problem of purchasing executives. Too often the request is merely for "a dozen files" or "1,000 feet of wire" or some similar general term that might apply to a wide variety of types or sizes and does not give the buyer a satisfactory description for ordering. Table 144 shows the extent to which this problem has been solved in the companies reporting. Large companies have been notably more successful than small ones in their efforts to make the purchase requisition clear and complete.

Table 144

Detailed Description of Material on Requisition

Description of Material Is Adequate on Original Requisition				Responsibility of the Purchasing Department for Amplification of the Description		
Size of Organization	Yes	No	Occasionally	Yes	No	Occasionally
Small	53%	33%	14%	100%		
Medium	60	31	9	80	13%	7%
Large	73	17	10	81	13	6
All reporting	69	21	10	85	12	3

The second part of Table 144 indicates that, whatever the shortcomings of the requisition may be in respect to the information presented, it is distinctly a responsibility of the purchasing department to clarify and amplify the description before proceeding with the purchase. The basic function of procuring the proper materials is not modified by any deficiencies in a system or in the human factor.

The most positive means of assuring that the requisition will indicate exactly what is needed is to place in the hands of each person responsible for the preparation of these forms a catalog or guide showing individual part numbers or standard descriptions to identify the material, so that practice will be uniform throughout the organization. Such standard stock catalogs have been rather widely adopted. Among the companies contributing to this study, the plan is used by 26% of the small concerns, 52% of the medium-size concerns, and 54% of the large companies, with an additional 5% adopting the practice to a limited extent on certain important items.

Effective use of the stock catalog is predicated upon a policy of standardization. The catalogs themselves range all the way from a simple list of items with standard descriptive names or numbers, to an elaborate compilation in loose-leaf form, with a mimeographed sheet for each item showing the complete specification, dimensional data and drawings when necessary, as well as the identifying part number. Utility companies and railroads have been leaders in the development of this procedure. Whether the expense involved in preparing and keeping up such a catalog is warranted and how detailed the catalog should be are questions that must be decided by each organization.

PRICING THE ORDER

Most purchasing departments prefer to have a definite price on every order issued, as price is one of the basic terms of a contract. From the viewpoint of the accounting department, every order should be priced to provide a basis for checking invoice charges, as well as for calculating and distributing costs. But while both of these viewpoints are agreed in principle, there are many cases in actual practice where the effort and cost of getting a firm quotation or competitive bids in advance of placing the order is disproportionately high in relation to the value of the material involved. Therefore, though price will always be a factor of interest and a responsibility of the purchasing department, a more favorable ultimate cost will sometimes be achieved by permitting some discretion and flexibility of procedure on this score. In a consideration of company policy on this question, it is evident that a saving of time and expense for one department (e.g., accounting or purchasing) may increase these factors in the other department, and a satisfactory decision must take both interests into consideration.

That the subject is debatable is evidenced by the report that 26% of the companies require prices to be shown on all orders, while 61% place orders for common items with regular suppliers without a definite price, and 13% occasionally do so. Some types of purchases, on which orders may reasonably be placed without first securing a definite price to be included as a part of the order, include the following:

Orders representing a very small expenditure.

Orders for commonly recurring items, placed with regular suppliers of known reliability. The purchasing department would normally be advised of any price changes on such items.

Orders for emergency repair materials in the case of a breakdown or other emergency, where lost production time would more than offset any possible savings effected by getting bids.

Orders for materials on which there is no real competition, including some raw materials, items covered by patents or licensing agreements, exclusive distributorships, or replacement parts which must be procured from the original manufacturer.

In the normal conduct of a purchasing department, there are various means of determining the purchase order price with reasonable certainty, yet without spending the time and undertaking the large amount of detail involved in securing quotations from one or more sources of supply for each transaction. One of these is reference to suppliers' published catalog prices. The legal aspect of whether a catalog price constitutes a firm bid or offer involves a consideration of the time element and other factors; especially in times of rapidly changing market conditions, most published price lists are qualified by the notation, "Prices subject to change without notice." Nevertheless, a comprehensive catalog file, kept well up to date, is a valuable guide to the pricing of orders without constantly issuing calls for bids.

Some companies maintain their own purchase price list by securing quotations on materials or supplies in standard use on a monthly basis or for some other stated period. For example, one large manufacturing concern, with branch purchasing offices, calls for monthly bids on a list of approximately two hundred items of mill supplies, and places its many small orders for such supplies on the basis of these quotations. In this case it is stipulated that the quotations shall hold throughout the month, though no formal contract is executed and the specific quantity requirements of the various items are not known.

Some companies are guided by the prices prevailing on the previous order in pricing purchase orders for common items. Some raw materials and manufactured products are sold on the basis of industry-wide published price lists, and others are sold in openly recorded commodity markets, so that a current quotation is readily available without calling for a specific bid.

Quotations given verbally or by telephone are accepted for pricing purposes by 94% of the companies in this study, though a number add the comment that such quotations are "subject to confirmation." There is a possibility of occasional errors in this verbal procedure, but it does expedite and simplify the purchasing process to a great degree, and the prevailing standard of business ethics is apparently high enough to permit a very general reliance upon this method when dealing with regular suppliers.

COMPETITIVE QUOTATIONS

In 19% of the companies, competitive prices are required on all purchases, while another 3% require competitive prices on nearly all purchases. The other 78% report a more flexible policy.

TABLE 145

PRACTICE AS TO REQUIRING COMPETITIVE PRICES ON ALL PURCHASES

Size of Organization	Yes	No	On Nearly All
Small	13%	87%	
Medium	16	80	4%
Large	20	77	3
All reporting	19	78	3

In purchasing for governmental bodies, where procedure is prescribed by statute and a minimum of discretion is permitted to the purchasing officer, the law generally requires the securing of competitive bids on all purchases and award of the order to the lowest bidder. To determine the extent of this policy in governmental buying, the twelve reports in this classification were separately analyzed. Seven require competitive bids on all purchases regardless of amount, while five allow some exceptions on orders of small financial value, fixing the limit within which this requirement may be waived.

Since the great majority of industrial concerns permit exceptions from the rule of competitive bidding, there is significance in the question, "Where do you draw the line?" The answer most frequently given, reported in 43 cases, is that this matter is left to the discretion of the purchasing agent. Other companies set a stated value per order, above which quotations are required; this value ranges all the way from $25–$500. Among the typical replies are:

Prices required on new and nonstandard items, not on catalog or contract items.

Prices required on special items, unusual items, or large quantities.

An air transport company draws the line "where, due to conditions peculiar to this industry, we have only one source of supply."

An engineering company states, "We use judgment as to whether there may be a change in price or some new material."

A manufacturing concern reports: "We purchase a great many small items whose value is less than the time consumed in getting competitive prices. No competitive prices are secured for breakdown repairs or for repairs to equipment or machine tools that must be purchased from the original manufacturer, except where the anticipated cost is large enough to require special consideration by our Operating Committee."

WHO IS ASKED TO QUOTE?

When the use of competitive quotations is indicated, the question arises concerning the list of vendors to whom the inquiry should be sent. The present study indicates that in 90% of the cases this decision is a responsibility of the purchasing department alone, while in the other 10% it is a joint responsibility of the purchasing agent and the department head or technical executive for whom the material is to be purchased. The latter group would include those special purchases in which a chemist, for example, keeps in close touch with new developments and unusual products, and is in a position to offer valuable assistance as to the most promising sources of supply.

There is general agreement that the purpose of competitive bidding can be adequately served by issuing a limited number of invitations to quote, and that no useful purpose is accomplished by issuing invitations to vendors who would not be considered acceptable suppliers even though their bid might be low. To go beyond this point is merely to incur useless expense, both in the purchasing department which issues the request for quotations and in the companies which are asked to estimate and bid. The exception to this practice is in the field of governmental buying, where public advertisement of proposed purchases may be required and all potential suppliers may submit their quotations.

The usual practice on items of standard use is to maintain a suppliers' list directly on the purchase record for each item. Standard purchase record cards contain spaces for listing alternative sources of supply. These records rarely provide for more than six or eight vendors' names, and frequently contain only two or three entries, though in a few cases the list may be extended to include ten or twelve vendors. This practice indicates that for ordinary purposes competitive bidding by six or eight potential suppliers is sufficient and economical.

The selection of these prospective vendors . . . includes checking the facilities and the responsibility of various possible sources of supply against whatever reference information is available, with particular weight given to previous experience. It is obvious that every company included on this list would be considered a satisfactory supplier (provided that its bid was favorable as to quality, price and service) both by the purchasing department and by the technical and production departments in those cases where such additional authorization is required.

AWARDING THE BUSINESS

After competitive quotations are received, they are compared for the purpose of selecting a supplier and awarding the order. On most items (92%) this process is a simple tabulation, on the basis of which the buyer can readily arrive at a decision. In other cases, a more detailed analysis is indicated, and the decision is more likely to be arrived at jointly by the purchasing agent and other executives. Such special purchases include engineering appliances and machinery, new equipment, capital items, intricate or large equipment, and certain raw materials. Though 28% of the replies show that the purchasing agent has the final responsibility for selecting the vendor even in such special cases, the wise purchasing agent will take advantage of the counsel and respect the judgment of his fellow executives in making his analysis and arriving at a decision. In 41% of the replies, such a conference method is reported as prevailing practice.

Tables 146 and 146*a* present a general analysis of procedure in the 8% of purchases considered "special" and a further breakdown in respect to machinery and technical equipment. The purchasing agent is a factor in 65% or more of such decisions.

TABLE 146

RESPONSIBILITY FOR DECIDING AWARD OF BUSINESS FOR SPECIAL PURCHASES

Size of Organization	P.A. and Dept. Head	P.A. and Official	Pur. Agent	General Manager	P.A. and Engineering Dept.	Executives or Laboratory	Not Stated
Small	29%	14%	14%	....	22%	14%	8%
Medium	12	22	28	8%	10	18	2
Large	11	17	29	11	11	16	5
All reporting	12	18	28	10	11	16	5

TABLE 146*a*

AUTHORITY TO DECIDE VENDOR ON SPECIAL PURCHASES SUCH AS MACHINERY, TECHNICAL EQUIPMENT, ETC.

Size of Organization	P.A. and Dept. Head	Technical Com.	Pur. Agent	Dept. Head	Gen. Mgr. or Supt.	P.A. and Com.	P.A. and Engr. Dept.	Discussed by All Interested	Executives
Small	27%	13%	27%	...	13%	7%	13%		
Medium	27	14	9	9%	2	16	7	9%	7%
Large	22	8	17	7	8	15	11	6	6
All reporting	24	10	15	7	6	16	10	6	6

B. WHAT MOTIVATES BUSINESS BUYERS

BY DELBERT J. DUNCAN

Since the beginning of serious study of marketing principles and methods and since the development of a literature in this field, students and businessmen alike have accepted with little or no question the often-repeated statement that purchases of industrial goods of all types are motivated by rational considerations. Because such goods were bought for business purposes it seemed entirely logical to assume that *reason* and *judgment*, rather than *emotional reactions*, constituted the factors that motivated their purchase. It appeared logical, also, to assume that the same conditions were true when consideration was given to the selection of sources of supply from which the goods were obtained.

Business in general, of course, is governed by the *profit* motive; but in practice this motive resolves itself into a large number of interrelated parts or motives subordinate to this major objective. Because of the difficulty involved in defining and classifying these subordinate buying motives, very few attempts have been made to do so. No comprehensive list of such motives is available in which an attempt is made to explain the meaning of the term or terms used, so that it is impossible for one to distinguish clearly between the motives.[1] A case in point is the word "efficiency," which may mean almost anything and may be interpreted to include or to exclude various other motives.

Purchases of industrial goods are motivated by a great many influences which operate inside and outside particular business establishments. These influences are difficult to define and to classify because they vary among different types of goods and at different times. This is true particularly of those outside the confines of any one establishment. External influences, such as general business conditions, stability or instability of price levels, and the activities of government designed to enlarge supervision and control over business operations have always been considered important, and their importance has probably never been greater than during recent years. Internal influences, the fundamental motives or reasons why purchases of a definite product or products are made by a particular company and why a particular source of supply is utilized, likewise have received considerable emphasis from students of marketing and increased attention from businessmen in recent years.

Probably the majority of executives who influence purchases in industrial plants are inclined to question the value of any detailed breakdown of buying motives because, in their judgment, purchases are governed solely by quality, price, and service considerations, once the need for the purchase becomes evi-

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Source: *Harvard Business Review*, Vol. XVIII, No. 4 (Summer, 1940), pp. 448–454. Reprinted by permission.

[1] Vergil D. Reed, for example, lists 47 "types of appeal" in terms of major motives taken from a grand total of 5,803 motives tabulated under his direction, but he makes little effort to define the meaning of the terms used. [See *Advertising and Selling Industrial Goods* (New York, McGraw-Hill, 1936), p. 60.]

dent. This attitude is partially responsible, at least, for the failure to develop a logical and useful summary of buying motives for industrial goods from the buyer's point of view, an attitude thoroughly justified because no conclusive demonstration has been made of the value of such a summary. A summary of this nature, however, would appear to have the following advantages among others: (1) to provide the purchasing officer and others influencing purchases with a reminder or check list in their purchasing activities and thus to insure that all important factors are taken into account when orders are placed; (2) to furnish the purchasing executive and other officers concerned with additional yardsticks upon which to base their decisions in those instances in which quality, price, and service considerations are identical for all practical purposes; and (3) in general to make possible the more effective performance of the purchasing function.

The present discussion is based on a study that was undertaken mainly for the following purposes: (1) to determine the nature and the rational or irrational basis of the more important buying motives for industrial goods; (2) to compare the *specific* buying motives revealed through investigation of buying practices with those determined through an examination of appeals used in industrial advertising; and (3) to ascertain the *general* influences which cause industrial buyers as a whole to buy or not to buy at a particular time or during a particular period.

Results of Earlier Studies

When Professor Copeland published his *Principles of Merchandising* in 1924, he devoted a chapter to "Buying Motives for Industrial Goods." [1] These motives included both *general buying* motives and *patronage* motives, and were determined through an examination of more than 1,000 advertisements in a variety of business magazines, although the results of the examination were recorded for only 754 of this number.

In 1936 Vergil D. Reed revealed the results of a similar study made to determine the buying motives for industrial goods and conducted on a much more extensive basis.[2] His results covered a study of the advertising appeals used in 3,640 advertisements appearing in seven trade magazines during the ten-year period from 1924 through 1933.

The authors of these studies were fully aware of the fundamental assumption upon which this method of determining the buying motives for industrial goods was based. This assumption is that executives in charge of advertising and their advertising agencies know the major considerations which influence the purchase of different types of industrial goods and that they consequently appeal to these motives. Such assumption may or may not be justified, depending on the recognition given by the individual or individuals to the fact that successful selling of industrial goods rests upon the foundation of a working knowledge of how and why the men in industrial plants buy. In any case, it seems advisable to check the accuracy of this assumption through the employment of a different research procedure.

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[1] Melvin T. Copeland, *Principles of Merchandising* (Chicago, Shaw, 1924), Chap. 7, pp. 190–215.

[2] Reed, *op. cit.*, pp. 48–65.

Both Copeland and Reed used the words "buying motives" in the sense that they constituted the reasons why a customer bought a particular commodity or type of article, and that "patronage motives" were the motives that induced customers to trade with particular firms. Buying motives are those influences or considerations which provide the impulse to buy, induce action, or determine choice in the purchase of goods or services. These influences or considerations apply to products and to firms selling such products. Those which apply specifically to products have been termed "product motives" in this study. On the other hand, the term "patronage motives," or the reasons which cause buyers to trade with particular firms in preference to others handling the same or similar goods, has been retained. Both types of motives vary in importance with respect to each other among different types of industrial goods and, to a lesser extent, at different times.

PROCEDURE

In the development of a comprehensive summary of the influences responsible for the choice of particular products and particular sources of supply, it is probably more logical to go directly to executives who take part in purchasing transactions than it is to examine industrial advertisements and to derive motives from the appeals used. Moreover, when the more direct method of approach is used, it would be highly desirable to sit at the desk of each purchasing officer and other executive concerned and analyze each transaction as it occurs. If this were not possible, probably the next best way would be to visit each purchasing executive and ask him to describe various types of buying situations that had arisen in his company and the procedure and considerations that were involved in arriving at decisions to purchase.

This method, of course, restricts judgments and opinions solely to purchasing officers. Further, when it is employed, it is essential that its limitations be recognized and that proper allowance be made for it both during and after the visits. When asked to explain "why" a particular purchase was made, the typical purchasing executive, considering himself a rational individual, assigns reasons which satisfy him as having determined his choice. Unfortunately for the investigator, however, this takes place *after* rather than *before* or *at the time of* the purchase. In other words, the buyer has *rationalized*—there is *ex post facto* justification of the actions which have taken place. Although the reasons given may be sincerely believed by the purchasing officer to be responsible for his actions, they may have very little to do with the actual motivation of the choice or decision in question and may even be definitely misleading.[1] In view of this situation, even though the investigator may exercise great care to secure information that will be reasonably accurate and useful, some allowance must be made for the conditions that have been described.

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[1] For a detailed discussion of this and related topics see Robert N. McMurry, "Finding the Why in Buying," *The Management Review*, Vol. XXV (April, 1936), p. 107.

To minimize the problems and difficulties outlined, a procedure designed to insure a reasonable accuracy was worked out carefully and adhered to closely. A considerable part of the information obtained is the result of personal interviews in which no fixed questionnaire form was used, although a definite plan for handling the interview was worked out in advance.[1] Executives of industrial plants who were known to be in sympathy with research studies and who were friends of the investigator were called on first. They were encouraged to talk freely of their experiences in purchasing industrial goods, and the only questions asked were those designed to prevent the discussion from straying from the main issues.

As a result of these personal interviews, a tentative list of motives, classified as product and patronage motives, was prepared and submitted to the membership of the New England Purchasing Agents' Association for criticism and suggestions. When the returns were tabulated, the following buying motives were formulated:

PRODUCT MOTIVES

Ability to increase the salability of the user's product: by adding greater desirability, a new selling point, a new advertising appeal, a new use or application, etc.

Accuracy: characterized by exactness and precision in performance; free from mistake or error.

Adherence to requirements: established by local government, such as building code regulations.

Adjustability: can be made to conform to varying jobs and varying conditions because of changed product specifications, varying size of order, etc.; flexibility in use and rate of operation.

Appearance: outward look or semblance of the product; condition of surface and kind of lines; perhaps reflecting harmony with trend toward streamlining.

Cleanliness: is a clean product, contributing by its use to cleanliness of the user's product through clean plant, equipment, workmen.

Container: is container a relatively permanent one necessitating its return to supplier when empty, or is it temporary and nonreturnable?

Dependability: resists wear; has a long life, thus contributing to economy in use.

Ease of operation: simple to operate; does not require strenuous physical effort or special skill on part of workmen.

Ease of repair: because of standardized parts, simplicity of construction, or for other reasons.

Economy: involves comparatively low (*a*) initial purchase cost; (*b*) maintenance or upkeep cost; (*c*) operating cost, including power and labor costs.

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[1] A number of studies of buying motives and buying habits for industrial goods, based largely upon personal investigations involving the detailed analysis of actual purchasing transactions, have been made. Among the better known studies are those of the McGraw-Hill Book Company and the survey entitled "Who Buys for American Industry?" made in 1927 by R. O. Eastman for the A. W. Shaw Company.

Portability: is easily handled or transported because of light weight, small size, chemical properties, or for other reasons.

Productivity: yields comparatively high output of a given quality or standard of product; rate of performance as indicated by ratio of the amount of work accomplished to time taken.

Purity: free from foreign or adulterative matter.

Quiet in operation.

Replacement: frequency of, brought about by changes in the arts or for other reasons.

Right quality: the class, kind, or grade of product most suitable for a specific purpose.

Safety: is free from danger, injury, or damage to customers or workmen, or to itself in case of a machine; perhaps leads to avoiding legal claims or to lower insurance rates.

Simplicity: is simple of construction, installation, or assembly.

Space saving: is compact; is easily stored; perhaps can be folded or deflated.

Standard make: is of standard make; known and recognized to be of reputable quality; possibly can use tools and parts manufactured by several suppliers.

Strength: is tough; resists shock or vibration; capacity for endurance; possibly ability to assume load in excess of rated capacity for short periods of time.

Time or labor saving: saves man-hours in operation.

Uniformity: characterized by continued and unvarying sameness in grade or quality of all units; low deviation from a standard.

PATRONAGE MOTIVES

Accessibility of seller: nearness, ease of communication.

Advertising and sales promotion assistance: provided by seller.

Completeness of stock: variety of selection.

Continuous supply under all conditions: ability of seller to furnish requirements constantly.

Cooperation: of seller in solving problems of buyer; complete information regarding uses of the product.

Easy replacement of parts: because of standardized parts, nearness of stocks, or for other reasons.

Family or friendship connections: between seller and buyer.

Financial or managerial connections: between seller and buyer.

Liberal credit: allowing period of time for payment equal to the most favorable obtainable from other sources or beyond that customary in the trade.

Low prices: net cost below that obtainable for similar quality at same time by other suppliers. This may be caused by (1) lower original list or quoted price, (2) larger discounts, and (3) a combination of these two.

Offer of services at no extra charge.

Past services rendered; satisfactory relationships.

Quick and reliable delivery of product.

Quick repair service: because of nearness of seller's plant or through maintenance of strategically located service stations.

Reciprocal patronage: the selling firm buying from, as well as selling to, its industrial customers.

Reliability of seller: reputation for fair dealing; exact fulfillment of specifications; financial stability.

Reputation: estimation in which firm is held by industry because of progressive or conservative policies.

Research and pioneering carried on in the field by seller.

Trade-in allowance: policy of seller in granting and the amount allowed.

RESULTS

These buying motives were incorporated in a questionnaire which was distributed to a representative list of approximately 400 members of the National Association of Purchasing Agents located in all sections of the United States; 87 returns were received from firms whose annual purchases exceeded $220,000,000. Since it was recognized that motives differed among different types of industrial goods, informants were requested to indicate the more important ones for heavy machinery, for raw materials, and for supplies. Informants were also asked to answer other questions bearing on purchases of industrial goods. Answers given in the questionnaires returned and in personal interviews lead to the following generalizations:

1. Many purchases of industrial goods are made on a nonrational basis as a matter of habit or in accordance with past custom. In some plants, the purchase of raw materials and supplies is motivated more by emotional considerations than by rational motives. This statement is based upon personal observation of purchasing transactions and would be difficult to substantiate completely in any other way. Industrial executives participating in decisions to purchase are likely to rationalize certain actions after these actions have taken place, but some cases were encountered in which executives interviewed experienced considerable difficulty in finding rational considerations that influenced their decisions. In the light of this situation, it appears advisable to question seriously the continued and widespread use of such terms as "rational" and "emotional" when referring to the bases upon which industrial goods and consumers' goods respectively are purchased, and to suggest that different and more appropriate terms be used.

2. On the assumption that the need for industrial goods exists and has been recognized, the more important product and patronage buying motives for heavy machinery, raw materials, and supplies are as follows:

I. Heavy machinery
  A. Product motives
    1. Economy
    2. Productivity
    3. Dependability
    4. Time or labor saving
    5. Durability

- *B.* Patronage motives
  1. Reliability of seller
  2. Cooperation
  3. Low prices
  4. Quick repair service
  5. Past services rendered; satisfactory relationships

II. Raw materials
- *A.* Product motives
  1. Right quality
  2. Uniformity
  3. Dependability
  4. Purity
  5. Ability to increase salability of user's product
- *B.* Patronage motives
  1. Reliability of seller
  2. Continuous supply under all conditions
  3. Accessibility of seller
  4. Low prices
  5. Quick and reliable delivery of product

III. Supplies
- *A.* Product motives
  1. Right quality
  2. Dependability
  3. Uniformity
  4. Economy
  5. Durability
- *B.* Patronage motives
  1. Reliability of seller
  2. Continuous supply under all conditions
  3. Accessibility of seller
  4. Low prices
  5. Quick and reliable delivery of product

3. Although recognizing the existence of other motives, numerous executives influencing purchasing will continue to disregard as unimportant motives other than quality, price, and service until the time when the value of taking into account additional considerations is more clearly demonstrated.

4. Both rational and emotional influences motivate the purchase of industrial goods. Because rational motives predominate, however, and because by and large they are the governing factors, industrial advertisers have been correct in appealing to these motives. Although comparison is difficult because of differences in terminology and definition, it is possible to draw some interesting relationships between the motives revealed by this study and those listed by Reed.[1] Reed reports that efficiency, economy, and quality appeals, plus those based on the desirability of a particular source of supply, are used most commonly in the advertising of major equipment; results of this study indicate that the most important product buying motives for heavy machinery are economy, productivity, saving of time or labor, and dependability with respect to performance. In the case of patronage motives for heavy machinery, broadly classified as institutional motives by Reed, this study indicated that reliability of

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[1] *Op. cit.*, p. 60.

the seller ranks first, followed by low prices and the cooperation given by the seller in solving problems of the buyer.

When supplies are considered, similar results are apparent. Reed lists the appeals of efficiency, economy, quality, durability, and protection from loss as used most frequently in industrial advertising. Purchasing executives indicate that the motives of right quality, dependability, uniformity, economy, and durability are most important in determining choice of product; and that reliability of the seller and continuous supply under all conditions are the chief considerations in choosing a source of supply. Lack of comparable data makes further comparisons inadvisable.

5. Because in the large majority of instances more than one executive influences the decision when purchases of heavy equipment and raw materials are made, and because variations exist in the training, experience, and points of view of executives, purchases of these types of industrial goods are motivated by several considerations all closely interrelated but nevertheless distinct. Although there is disagreement with respect to the considerations of major importance, there is very little concerning the several motives which are decisive.

6. One of the more important *general* influences which causes industrial buyers as a whole to buy or not to buy at a particular time or during a particular period is their confidence with respect to the stability of price levels. This stability in turn is affected by general business conditions, particularly their effect upon the industry concerned. When frequent fluctuations in prices take place, industrial buyers restrict their commitments to a minimum; and when prices are stable, purchases are made in greater amounts with increased confidence.

7. During recent years purchases of industrial goods have definitely reflected the attitude of business executives toward the policies and practices of the Federal government and the relationship of these policies and practices to the business structure. Many industrial executives express a lack of confidence in the continuance of the *status quo* and are unwilling to make substantial commitments until they are able to see farther ahead than they can at present. Numerous others believe that the most important single factor needed to bring about full recovery in the industrial goods industries is greater cooperation between business and the Federal government.

8. Emotional reactions of executives influencing purchases play a significant part in industrial goods activity. These reactions are the result of individual and group interpretations of the short-time and the long-time effects of certain events on industrial activity. The rise and fall of political fortunes during the coming months, for example, and the victories and failures of the nations at war, will cause periods of emotional stress which are certain to affect industrial purchasing practices.

9. Generally speaking, purchases of industrial goods are made with greater caution immediately following periods of inventory losses than at other times. The precipitous decline in business activity during 1937, for example, and the severe inventory readjustments that accompanied it caused many purchasing officers to become "inventory conscious." As a result, most purchasing com-

mitments for some time thereafter were made on a strict hand-to-mouth basis or on one or two months' requirements. Such a policy was followed until losses experienced previously were forgotten or until events occurred which rendered departure therefrom advisable.

MARKETING RESEARCH IN AMERICAN INDUSTRY

BY HEUSNER, DOOLEY, HUGHES, AND WHITE [1]

I. INTRODUCTION

This is an objective study by the Committee on Marketing Research Activities of the American Marketing Association in collaboration with the Distribution Committee of the National Association of Manufacturers [2] to find out the extent to which marketing research is utilized in American industry, the purposes for which it is employed, the type of organization used by firms in performing the marketing research function, and the cost of such research programs. Findings are based on mailed questionnaires, with a net return of 36 per cent [3] and, while the sample makes no pretense of being representative of all American industry, the Committee feels that the replies represent a good cross section of the problem area of interest.

Since the study was started at the peak of war production and continued through the first phases of the reconversion period (to May 1, 1946), it is quite possible that the figures are somewhat understated because of the sellers' market situation during this time and the fact that some of the research men were on leave with the armed forces. This may be offset by the fact that some of the research activities during wartime were only temporary because of the peculiar requirements of reconversion planning and the tax situation. The Committee feels that the study reflects a reduction from normal in terms of the size of departments rather than the converse.

This report, it is hoped, will be of real assistance to those in the marketing

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Source: *The Journal of Marketing*, Vol. XI, No. 4 (April, 1947), pp. 338–354, and Vol. XII, No. 1 (July, 1947), pp. 25–37. Reprinted by permission.

[1] Charles M. Dooley, Owens Illinois Glass Company; Gordon A. Hughes, General Mills, Inc.; Percival White, Market Research Company of America; and William W. Heusner, Pabst Sales Company, Chairman.

[2] Particular mention should be made of the following members of the American Marketing Association who also were members of the Subcommittee on Marketing Research Activities as a Management Tool of the Distribution Committee of the National Association of Manufacturers: Mr. Everett R. Smith, Macfadden Publications, Inc.; Mr. H. V. Pelz, Traffic Audit Bureau; Mr. Donald M. Hobart, Curtis Publishing Company; Mr. Lyman Hill, Servel, Inc.

[3] The mechanics of mailing and handling the replies was performed by the National Association of Manufacturers, and the completed questionnaires were turned over to the A.M.A. Committee for compilation. The questionnaire was mailed to some 13,000 members of the National Association of Manufacturers and followed up with two reminder mailings. Nearly 5,300 questionnaires were returned as a result of these mailings, of which 4,786 were usable, thus netting a final return of 36 per cent of the membership.

field and to American business in general in properly measuring the need for research and in setting up sound Marketing Research Departments in their organizations. Such departments, properly organized and staffed, should be of real assistance in increasing sales and in reducing distribution costs and thus should become a tangible asset in industry in the competitive years ahead.

It is further hoped that this study will be the first of such investigations, and that subsequent studies will be made to determine the trend in the use of marketing research in industry. It is also hoped that such further studies will go into in substantially more detail and amplify many points that the Committee did not feel justified in investigating at this time. Further studies might in addition investigate the organization and operation of established research departments in a manner similar to, but more fully than, the recent National Industrial Conference Board studies on this subject,[1] for the purpose of establishing trends.

II. WHO DOES MARKETING RESEARCH AND HOW IT IS DONE

The first question that the present study attempted to answer was: "What kind of companies do marketing research?"

It was found that many companies who did not have Marketing Research Departments actually did research on an unorganized basis as a function of one or more of their line executives.

Many of the companies also reported that they did no marketing research although the Committee is convinced that all companies perform some marketing research functions or it would be impossible for them to remain in business. In these cases it seems reasonable to assume that the respondents failed to recognize the functions they performed as marketing research functions, probably considering them as normal functions of the line positions held by the men performing these functions.

It would appear, therefore, that industry management in these cases has not been impressed with the need for separating a diagnostic or measurement function from the operating function that is measured or diagnosed. The Committee feels that this is probably one of the most serious weaknesses of management on the marketing side, since it fails to take into consideration that such organizations are asking line executives, responsible primarily for operation, to measure their own results and diagnose their own weaknesses. This is tantamount to asking the shop foreman to inspect and pass or reject the products made in his shop, when he is primarily concerned with producing those items in maximum volume at the lowest possible cost.

PERCENTAGE OF COMPANIES REPORTING MARKETING RESEARCH

Approximately 38 per cent of the 4,786 companies responding to the questionnaire reported doing marketing research of some kind, either through an organized department or through a line executive. Chart 1 shows the comparison

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[1] National Industrial Conference Board, *Organization for Market Research*, Parts I and II, 1945.

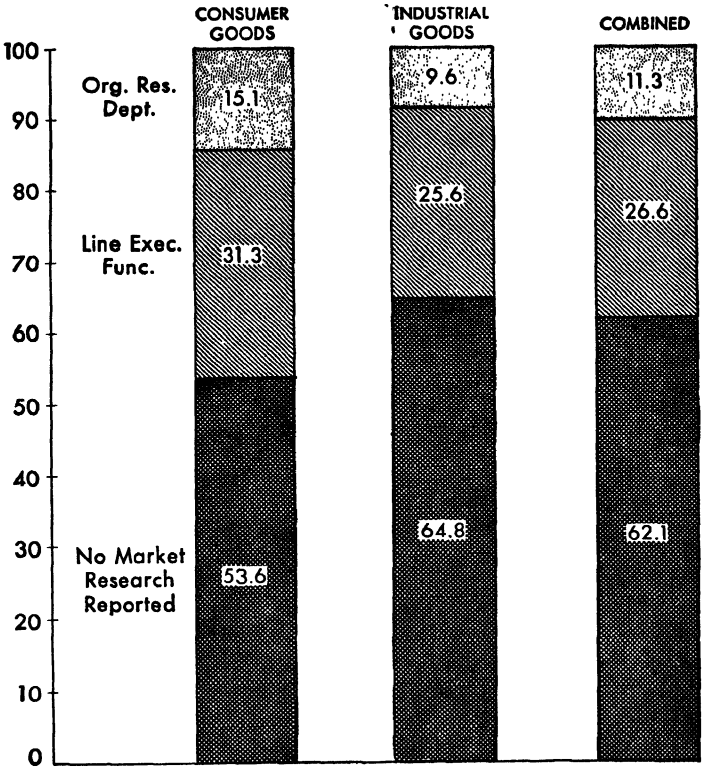

CHART 1. Companies Doing Marketing Research.

for two types of companies and for all companies combined. The following table gives data for all companies:

Marketing Research Done	Number of Companies	Per Cent of Respondents
With Marketing Research Department....	539	11.3
As line executive function................	1,273	26.6
No marketing research reported..........	2,974	62.1
Total...............................	4,786	100.0

For the purpose of this study, a company was considered as having a Marketing Research Department if it had one or more full-time employees engaged in performing any of the 16 functions commonly recognized as marketing research functions. (See captions in Table I [page 89].) This person, where it was an individual, might have been called Assistant Sales Manager, Assistant to the

President, Sales Analyst, etc., and all of these titles were used. Moreover, his functions may have been only those of compiling sales statistics and thus have little in common with the broader aspects of marketing research, yet these functions were included in our list of functions and he was considered for purposes of this report as a Marketing Research Department.

MARKETING RESEARCH BY TYPE OF PRODUCT AND SIZE OF COMPANY

There appears to be a significant difference between the consumer goods companies where 46.4 per cent do marketing research in some manner, 15.1 per cent through organized departments; and industrial goods companies where 35.2 per cent perform the functions, 9.6 per cent through an organized research department. (See Chart 1.)

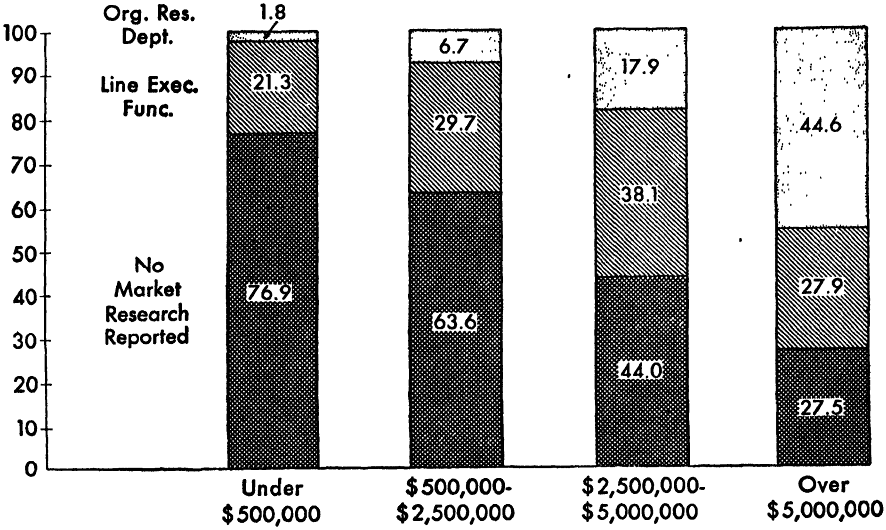

CHART 2. Companies Doing Marketing Research by Size of Company (Net Sales).

Where it was impossible to determine product type, the percentage doing marketing research was smaller (15.5 per cent) but our data give no clue to the reason.

Size, as would be expected, seems to be an important determining factor in the establishment of a Marketing Research Department. For all companies reporting, the percentage with organized departments varies from 1.8 per cent for companies with sales under $500,000 to 44.6 per cent for companies with sales over $5,000,000. (See Chart 2.) Among consumer goods companies the percentage with research departments varies from 3.1 per cent among companies with sales under $500,000 to 51.3 per cent among companies with sales over $5,000,000. The variation in industrial goods companies is from 1.4 per cent in the smallest group to 40.5 per cent among the larger companies.

In general, it may be said that at the present time relatively few companies with sales under $2,500,000 use established departments for performing research functions. This, however, probably varies to some extent with the product made and the distribution channels through which it is sold. No tabulation was made using a breakdown by size by the 20 census classifications because the size of the sample did not permit of such fine analysis.

Similarly, size seems to be related directly to the number of companies that recognize that they perform any marketing research functions, either through line executives or through organized departments. (See Chart 2.) For all companies the percentage varies from 23.1 per cent for companies with sales under $500,000 to 72.5 per cent for those in the largest size group. Among consumer goods companies 28.5 per cent of those with sales under $500,000 perform marketing research functions while 80 per cent of those with sales over $5,000,000 do so. Among industrial goods companies the variation is from 21 per cent to 68 per cent.

Marketing Research Affected by Channels of Distribution Used

The channels of distribution used by respondent companies have a definite bearing on the number of companies performing marketing research functions. Where the chain of distribution is relatively direct, fewer companies perform these functions. Where there were intermediate steps in the distributive operation, the tendency to control and direct distributors through the functions of marketing research appeared to be stronger. This may indicate that those companies which sell directly may feel that their direct contact with the final purchaser obviates the need for marketing research. Certainly this assumption is dangerous for it means these companies are relying upon their sales forces for the reporting of marketing research data, and experience has demonstrated repeatedly that salesmen are seldom able to report facts objectively.

Among the industrial goods companies, those selling through distributors do marketing research more frequently (42.7 per cent) than those selling direct to industrial users (29.9 per cent). Among consumer goods companies, those selling through their own branches to the retailers do marketing research more frequently (60.3 per cent) than those employing other types of distribution. Of those selling direct to the retailer, 47.9 per cent do marketing research while 45.1 per cent of those selling through wholesalers to retailers use it. Only 36.3 per cent of those selling direct to the consumer reported using marketing research. (The sample of those selling direct to the consumer and those selling through branches to the retailer is too small to justify reliance on these percentages.)

Analyzing these figures, it is interesting to note that 51 per cent of the total companies in our sample that have organized research departments sell their merchandise to the consumer, i.e., direct to consumer, retailer to consumer, branches to retailer, and wholesaler to retailer to consumer. Forty and seventenths per cent of the companies reporting that a line executive handles the research activities sell through these channels. Only 31.5 per cent of the companies distributing their merchandise through the above-mentioned consumer goods channels said they did no marketing research as compared with 67.8 per cent of the companies distributing goods through distributors to industrial users and direct to industrial users. A small number (0.7 per cent) did not report the type of distribution used.

MARKETING RESEARCH BY PRODUCT CLASSES

That the product made by the company may be an important factor in determining whether a Marketing Research Department has been organized, and also whether any marketing research functions are being performed, is apparent from the analysis of types of marketing research done by the respondent companies classified by the 20 product classifications used in the Census of Manufactures.

While the total tabulation shows 37.9 per cent of the companies using marketing research, most frequent use is indicated in the food industry, 74.5 per cent; petroleum and coal industries, 72.2 per cent; iron and steel industries, 68.0 per cent; electrical machinery, 55.5 per cent; and printing and publishing industries, 50.4 per cent. Marketing research is used less by members of the apparel, lumber and rubber industries in which less than 25 per cent of the companies replying reported its use.

It is difficult to see why more of the companies in these latter classifications do not report using marketing research since their sales problems are highly complicated and competitive. This may be due in part to the smaller size of unit in the latter industries.

Apparently a classification of companies by size within product classes would reveal that the larger companies in all classes did research but that the large proportion of companies with low sales volume in the latter product classes reduces the percentage of marketing research users. The sample, however, is too small to make such cross-classification reliable.

The fact that such a large percentage of the companies selling to a mass market use some kind of marketing research probably indicates that companies with larger sales and advertising budgets feel that they can use marketing research more profitably than those with less extensive sales and advertising expenditures.

Manufacturers in industries such as textiles, apparel, furniture, rubber, leather and automotive products also sell to the mass market but do not make use of marketing research facilities to any great extent, possibly because brand advertising to the mass market is less widely employed, and hence there is less need for research on advertising effectiveness, and allocation, distribution and consumer and dealer reactions, etc.

III. MARKETING RESEARCH FUNCTIONS PERFORMED

Although it was recognized that Marketing Research Departments, where they are organized, usually perform a multitude of functions, it was felt that, for the purpose of this study, data on functions performed should be limited to those marketing research functions most common to such operations. After considerable thought sixteen of the most common marketing research duties were listed as typical and respondents were asked whether each was performed in their organization.

Number of Functions Performed

It was found that of the companies that had organized research departments, an average of 10.7 of the functions were performed while only 6.8 of the functions were performed in companies where marketing research was a line executive function. It appears that consumer goods companies perform slightly more of the functions listed than do industrial goods companies. It may be that more of the listed functions were applicable to consumer goods operations. The average is 10.7 functions for consumer goods companies and 9.9 for industrial goods companies that have Marketing Research Departments, and 6.9 and 6.3 functions respectively for companies where the research is done by a line executive.

Table I

Percentage of Companies Performing Marketing Research Functions

Types of Functions	Companies with Marketing Research Departments		Marketing Research a Line Executive Function	
	Consumer Goods (224 companies)	Industrial Goods (299 companies)	Consumer Goods (465 companies)	Industrial Goods (793 companies)
Appraisal of sales opportunities				
Setting quotas	72.3	57.9	52.5	43.3
Forecasting sales	84.8	81.6	61.7	64.4
Figuring sales potentials	84.4	83.3	52.5	53.7
Appraisal of sales performance				
Analysis of sales statistics	83.0	78.6	57.4	54.0
Measuring salesmen's performance	66.1	61.9	49.7	43.6
Appraisal of distribution and distribution methods				
Distribution studies	76.3	71.2	52.9	50.1
Distribution methods	67.4	64.5	50.5	38.6
Standards for distributors and retailers	45.1	36.8	26.5	21.2
Product studies				
Testing product preference	57.6	56.5	40.4	34.8
Product use	48.2	70.9	32.9	51.2
Testing package design	48.7	39.8	32.5	19.2
Appraisal of advertising				
Studies of advertising effectiveness	67.4	60.9	44.1	38.0
Economic studies				
Price studies	67.0	63.2	48.2	45.1
Demand studies	72.3	64.9	40.9	39.6
Analysis of business and industry	60.7	53.2	25.8	29.1
Consumer studies				
Consumer surveys	67.4	44.8	30.5	13.7

FUNCTIONS MOST FREQUENTLY PERFORMED

Forecasting sales and determining sales potential are the two functions most frequently performed among both consumer goods and industrial goods companies with research departments. Forecasting sales leads in frequency among companies where marketing research is a function of a line executive.

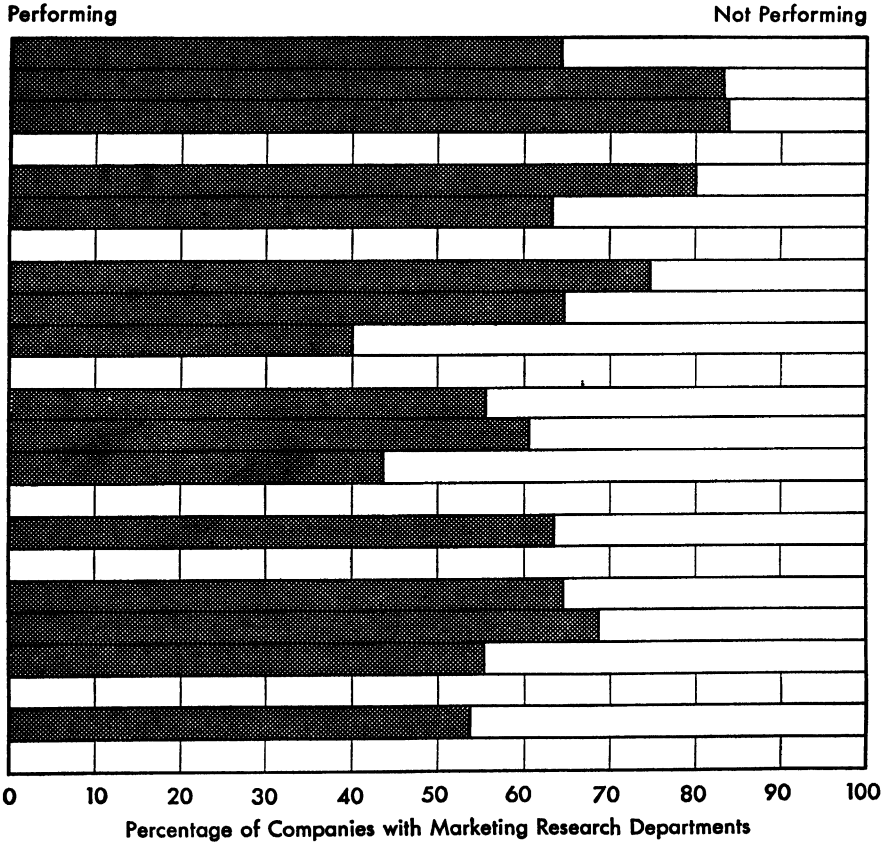

CHART 3. Marketing Research Functions Performed by Companies with Marketing Research Departments. (Bars represent functions as listed in Table I.)

For convenience and simplicity the functions have been regrouped into seven general classes, based on their ultimate purpose, in Table I.

Chart 3 shows by the white portion of the bars the room for increased marketing research activity even in companies with established Marketing Research Departments. This comparison reveals clearly both the relative importance of functions in each group of companies and the variations among groups.

It is clear that in all four groups, functions designed to appraise sales opportunities and sales performance are more commonly performed by all companies than are any of the other functions listed. It may be said that in general the respondent companies were more interested in the results of their sales and advertising activities and opportunities than they were in the means by which those opportunities could best be utilized, or in how the results could be improved. This is a little like locking the door after the horse is stolen and certainly points to the need for broadening marketing research activities in many companies to find out how sales and advertising results can be improved.

Functions Frequently Neglected

It would appear *a priori* at least that in all companies considerably more profit and better sales results would follow if more marketing research were done in the product functions, distribution functions and the advertising testing functions. The results of studies of this kind should certainly point the way to better sales and profit positions, and more studies of consumer product and brand preference would eliminate much of the waste occurring because of guesswork on the part of sales, production and advertising executives.

It is clear also that the complete marketing research job as defined (all sixteen functions) is performed more often by companies with organized research departments than where the operation is unorganized and is performed by line executives as an incident to their supervisory and operational duties.

The differences in the performance of functions appearing in the previous table between consumer goods companies and industrial goods companies are what might be expected. Industrial goods companies appear to be less interested in consumer preferences but considerably more interested in product use. Their interest is also low in packaging. Consumer goods companies, on the other hand, show considerably more interest in advertising, packaging and consumer preference.

These, in other words, appear to be natural differences and are closely related to the character of the product.

Need for Basic Economic Research

In both main groups the percentage of companies in which the economic analysis of business and industry is a marketing research function is substantially lower than the percentage that are forecasting sales, measuring sales potential and setting quotas, and the variation is larger among companies where marketing research is a line executive function than where there is an established Marketing Research Department. Yet it would appear to be impractical to attempt to establish sales potentials, forecast sales volume and set quotas until the position of the industry in the economic pattern of the country and the position of the company within the industry has been established.

One may infer from the data in this table that many of the line executives performing these marketing research functions, and only slightly fewer of the Marketing Research Departments, are not taking into consideration the basic economic factors that so vitally affect sales volume. Perhaps this is some indication of two possible weaknesses that appear to obtain in marketing research:

1. That some of the people doing marketing research in established research departments are not properly qualified for the jobs they hold.

2. That marketing research, performed by a line executive, is likely to be superficial and to suffer because of the pressure of the administrative duties of the executive. Probably no better argument exists for the establishment of an organized Marketing Research Department under a qualified research director.

RESPONSIBILITY OF MARKETING RESEARCH DEPARTMENT FOR FUNCTIONS

Because most established Marketing Research Departments cooperate with sales, advertising, production and other operating departments in most or all of the functions they perform, it was felt that this study should measure the degree of responsibility of the Marketing Research Department for the functions which it performs.

It was found that in nearly half of the cases, the Marketing Research Department had full responsibility for figuring sales potentials and conducting consumer surveys. In nearly half also they had partial responsibility for studies of distribution methods, determining new uses for old products and making studies of demand.

Probably more significant are the percentages of Marketing Research Departments that are indicated to have no responsibility for many of the functions normally considered as marketing research activities. Leading the list are the conducting of price studies, in which 26.6 per cent of the departments have no responsibility, followed by testing package design (24.1 per cent), economic analysis of business and industry (23.4 per cent) and setting standards for distributors and retailers (22.7 per cent).

This suggests the possibility that in many companies the reluctance of the operating departments to allow marketing research personnel to share their problems is preventing those persons in the organization who should be best equipped to perform some of these functions from doing so. Perhaps the abilities of the research department along the lines in which no responsibilities are indicated have not been properly sold to all operating department heads. Or perhaps in some of these instances the research department really has no special abilities that could assist in performing these functions. If the latter is the case, then a more experienced and broader research operation is indicated. If the former is the case, perhaps the relationship of the Marketing Research Department to the rest of the organization has made it difficult, if not impossible, for the research man fully to demonstrate his ability along these lines.

That the research department should cooperate and share responsibility with the sales department for the appraisal of sales opportunities and performance and for the appraisal of distribution and distribution method is, we think, sound practice. To carry full responsibility for these functions would only end in antagonism. But the number of departments, for example, that have no responsibility in measuring salesmen's effectiveness or in measuring advertising effectiveness indicates that some companies are not getting full value for their marketing research dollar.

Getting More Use from the Marketing Research Department

Detailed analysis brings out several other omissions that may be useful to management in securing more for their research dollar. In nearly 60 per cent (59.7 per cent) of the companies where organized Marketing Research Departments exist, no indication is given that the company has developed standards for distributors and retailers (54.9 per cent in consumer goods companies and 63.2 per cent in industrial goods companies). In 56 per cent of the cases there is no evidence that package design is tested (51.3 per cent for consumer goods companies and 60.2 per cent for industrial goods companies).

Nearly half (45.5 per cent) seem not to be worried about the preference of consumers (this figure is 32.6 per cent for consumer goods companies and 55 per cent for industrial goods companies). Likewise, the determination of consumer and dealer preference for products is being overlooked in over 40 per cent of the companies with established Marketing Research Departments (42 per cent and 43 per cent, respectively, in consumer and industrial goods companies).

In this connection it should be pointed out that some of the functions in our list of sixteen overlap, and it is possible, though not probable, that where a responding company checked an inclusive function, it failed or neglected or did not think it worthwhile to check a specific function included in the former.

The Most Valuable Marketing Research Job

As a whole, respondent companies showed much less uniformity in their statements of the outstanding research done by or for them than was evident in describing the functions and use of research. Selections range through a rather widely varied list of projects. Only three types of jobs stand out to any degree. Each of these represents about 10 per cent of the total mentions. They are:

1. Studies of market potentials
2. Developing or improving products
3. Studies of product demand

No major distinctions appear from a consideration of the choices by companies of different types and sizes. However, there is some indication that studies of market potentials are more important to companies engaged in manufacturing industrial goods than to consumer goods companies, whereas the position is reversed in studies on product demand. Projects related to product development seem to have been equally valuable to both types of companies.

A significant commentary on the recency of acceptance of marketing research as a business tool can be found in the fact that another 10 per cent segment of companies stated that the operation was too new with them to make it possible to answer this question.

In contrast to that situation, a considerable proportion of companies found it difficult to segregate one specific job for such evaluation. This situation is especially evident in the returns from the group in the largest size category, which seems to imply that they have done more marketing research extending over a longer period of time and can, therefore, survey the results less readily than is the case with smaller companies with less extensive and more recent experience.

IV. Size and Organization of Marketing Research Functions

In Section II it was shown that 37.9 per cent of the respondents in the survey performed marketing research functions in their companies. The following table shows this distribution:

Responsibility for Marketing Research	Number of Companies	Per Cent of Total
Have established Marketing Research Departments	539	11.3
Marketing research a line executive function	1,273	26.6
Total doing marketing research	1,812	37.9
Report no marketing research activity	2,974	62.1
Grand total	4,786	100.0

It is the purpose of this chapter to report on the way the marketing research function is set up within the company organization, the contribution of the established Marketing Research Department to the policy-making activities of the company, and the size of that operation in the 11 per cent of the companies where an established department exists.

Place of Marketing Research in Organization

Where marketing research has not become an organized department, this activity is the function of one or more of the line executives. Some idea of the importance attributed to this work by the respondent companies will be revealed if the proportion of companies where marketing research is performed by various levels of line executives is shown:

Executive Performing Marketing Research Functions	Percentage of Companies in Which Marketing Research Is a Line Executive Function
Top executive—president, partner, etc.	31.7
Vice presidential level	17.2
Selling department managers (sales, advertising, etc.)	44.1
Other department manager	3.3
No answer	3.7
Total	100.0

It is apparent that marketing research activities are considered of sufficient importance in nearly half of the companies (48.9 per cent) to engage the attention of the top management group (vice presidents and above) where there is no organized research department. In 44 per cent of the companies it is a function of one of the department managers in the marketing function of the business and in 3 per cent of the cases the function of department managers in the financial or production departments.

A similar situation is revealed where there is an organized Marketing Research Department, in the tabulation showing the executive to whom the head of the Marketing Research Department reports:

Executive to Whom Marketing Research Head Reports	Percentage of Companies with Marketing Research Dept.
Head of the company (president, board of directors, partner)	33.6
Vice presidential level	32.3
More than one of above	11.7
Selling department managers (sales, advertising, etc.)	15.5
Financial department managers (treasurer, secretary, computing dept.)	2.1
Committee and others	1.7
No answer	3.1
Total	100.0

In these cases, where the marketing research activity has been recognized sufficiently to achieve a separate organized unity, thè interest of top management in the work is even more pronounced, for 77.6 per cent of the Marketing Research Department heads report to top executives in management as compared with 48.9 per cent of top management executives doing marketing research where it is a line executive function. (See Chart 4.) The selling department managers seem to lose position where the Marketing Research Department is separately organized.

Only 11.7 per cent of the companies with departments make these men responsible for the research function while 44 per cent of the companies allow them to perform the function where marketing research is not organized. Certainly this is a recognition of sound organizational procédure since it is good organization to separate the appraisal of opportunities and results from the men directly responsible for the results.

But the fact that so many departments still report to Selling Department managers may be one of the reasons why the Marketing Research Department is not performing all the functions it should be equipped to perform, as indicated in Section III.

In the case of selling and advertising department results there is little check on the department managers other than sales records and selling cost analyses.

Comparison of these records may show very little since without the appraisal of sales opportunities it is impossible to tell whether a sales record is good or bad. To have such appraisals made by the executive responsible for results automatically places in his hands the judgment of his own activities. In no other department of business is it so difficult to judge results or so necessary to divorce measurement and appraisal.

Because of the difficulty of comparing effectiveness of sales effort, it is encouraging to see that in 31.7 per cent of the companies where marketing research is a line executive function, the chief executive performs the marketing research function and in 33.6 per cent of the companies with research departments the department head reports to the chief executive. In addition, in the latter case the chief executive is co-responsible with a vice president in many of the 11.7 per cent of the cases where the head of Marketing Research reports to one or more of the top executive group.

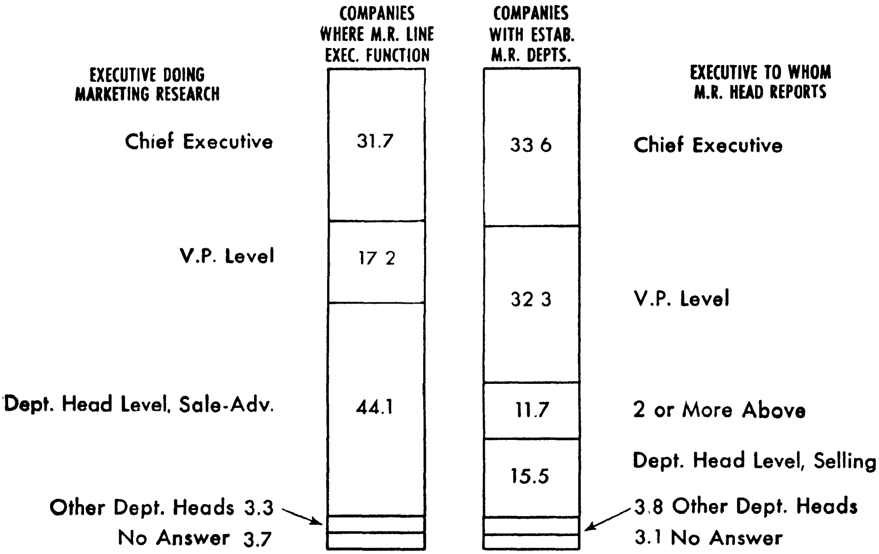

CHART 4. Place of Marketing Research in Company Organization.

In this third of the companies where the chief executive does, or is responsible for, marketing research, the study leaves the impression that the marketing research activity is considerably broader (more functions are performed) than in companies where marketing research is done by, or reports to, the sales or advertising vice president or managers.

Reanalyzing the data by the operating department head doing the work or to whom marketing research reports may throw some light on (*a*) the reasons for the growth of marketing research and (*b*) opportunities for increasing the scope of the work of the Marketing Research Department if it can be properly placed in the organization chart of the company. The accompanying tables summarize the data on the subject.

Executive Performing Function	Percentage of Companies in Which Marketing Research Is a Line Executive Function
Chief executive	31.7
Sales executive—vice president, sales manager	55.3
Advertising executive—vice president, advertising manager, sales promotion, merchandising manager	6.0
Financial executive	2.6
Production executive	0.2
Others and no answer	4.2
Total	100.0

Executive to Whom Marketing Research Reports	Percentage of Companies with Marketing Research Departments
Chief executive	33.6
Sales executive—vice president, sales manager	44.3
Advertising executive—vice president, advertising manager, sales promotion, merchandising manager	3.5
Financial executive—secretary, treasurer, comptroller	2.1
Committee or more than one of top management	12.1
Others and no answer	4.4
Total	100.0

Several conclusions are indicated by the data as recast in these tables. The first is that marketing research grew from the need for more accurate and more thorough appraisal of the opportunities facing the sales department and better measurements of the results of that department, and that much of the future growth of this activity will probably be attributable to the same need. This will become more and more true as the old hit-or-miss, rule-of-thumb, inspirational system of sales management is replaced by the more scientific, analytical type, and as the sales manager can and will welcome facts that will help him to improve the efficiency of his operation.

Another conclusion that may be drawn is that advertising, hard as it is to measure, is not receiving as much attention as it should. Certainly, with problems facing the advertising manager or the vice president in charge of advertising regarding advertising strategy, media, copy impact and accomplishment, brand buying habits and preferences, packaging analyses, profitability studies, etc., it is difficult to see why if Marketing Research Departments are to report to a functional executive, more do not report to advertising executives.

EFFECT OF PRODUCT TYPE AND SIZE OF COMPANY ON LOCATION OF RESEARCH DEPARTMENT

There appears to be no significant difference between industrial goods companies and consumer goods companies as to whom the head of the Marketing Research Department reports to where such a department has been organized. The chief executive of consumer goods companies is more likely to do the marketing research where this activity is a function of one of the line executives.

The size of the company, however, seems to have considerable to do with which executive does, or is responsible for, marketing research activities.

As might be expected, with increasing company size the chief executive seems to have less and less time for this kind of analysis and tends to turn it over to one of his line officers, where there is no research department. The vice president in charge of sales becomes more important as a factor performing these functions as the company grows. In companies with established departments, the percentage of Marketing Research Departments reporting to the president or chief executive also declines as the size of the company increases. The percentage reporting to the vice president in charge of sales increases, but the percentage responsible to the sales manager reaches its highest point in the two middle size groups and declines rapidly in those companies with sales volume over $5,000,000.

The reasons for these trends are, of course, somewhat obvious although it still is not clear why the percentage of Marketing Research Departments reporting to the chief executive should decline in the largest group of companies. In fact, properly organized and staffed, such departments could prove of more value to the chief executive of a large company than of a small one. Moreover, some of the functions normally performed by the well-organized Marketing Research Departments are of considerable more importance to the chief executive than to his vice presidents, particularly economic studies and studies of demand and price.

PARTICIPATION OF MARKETING RESEARCH IN POLICY MAKING

One measurement of the value of marketing research may be the extent that it assists in the development of company policy. The present study used this means to determine how solidly existing Marketing Research Departments had entrenched themselves in the companies. The replies indicate that the activities have proven their worth and it can be surmised that those companies, in which the head of the department does participate in policy making, are getting more for their research dollar than those companies in which he does not participate.

Company organization, personalities of executives and of the head of research, size and method of company operation are all contributing factors determining whether such participation exists. The Committee definitely is of the opinion that the company will secure a larger return on its investment where the research director, assuming he has ability, participates in policy decisions, at least to the extent of expressing his opinion based on his studies.

The following tabular statement reflects, at least quantitatively, the stature acquired by marketing research in its relatively short history to date:

Participation of Head of Marketing Research Department in Company Policy	Number of Companies	Per Cent
Participates	253	46.9
Does not participate	263	48.8
No answer	23	4.3
Total	539	100.0

As can be seen, in a little less than half of these companies, the head of the Marketing Research Department participates directly in the determination of company policy.

Although not shown in the data given, on a basis of a study of the detailed figures, this sharing of responsibility by the head of the research department is about equally extensive between consumer and industrial companies. The degree of participation is greatest among the smaller companies and least among the large companies. It appears that the breaking point, where the research executive participates in more companies than where he does not, occurs in companies having somewhere between 2½ and 5 million dollars of sales.

Looking only at the figures in this part of the study dealing with the research executive's participation in company policy making is something akin to seeing only the extreme end color bands in a color spectrum. There is a great deal of interest and value in between which is entirely missed unless one digs deeper into the comments and observations which accompanied the quantitative replies to this question. Several grades of participation as well as complete absence of participation are revealed in such a study, and inasmuch as they do not lend themselves readily to tabulation, we will try to describe them as well as is possible.

To begin with, there are definitely two schools of thought on the extent of responsibility of the head of the research department.[1] The one, of course, adheres to the premise that he should make the survey or analysis, present the findings with possibly his recommendations and so terminate his responsibility to the problem. The other school believes the technician should continue beyond this point, having a voice in what is to be done on the basis of his findings. Both schools are well and capably represented in this study.

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[1] In fact from the comments of respondents in answer to the question, "Does the head of your marketing research activity participate directly in the formation of company policy?" there seem to be three possible levels of activity along these lines: (1) *No participation.* (This seems to be rare; the market research functionary usually at least "sits in" during policy discussions. One reply: "No. Research activities are a service to the marketing functions of the business.") (2) *Advisory only.* (Examples: "Sits in on management meetings, policy meetings, and makes reports on management problems"; "The Market Research Department provides the management and/or the department heads with facts, figures, and other information as requested from time to time. It is represented on the various committees and acts in advisory capacity to management"; "He participates in policy formation to the extent that he advises with policy making executives of the company on all matters in which research has a bearing.") (3) *Actively influential in policy making.* (Examples: "Member of Planning Committee. Member of top management group that formulates all company policy"; "He is a member of the Plans Committee and the President's advisory Committee—both of which function on policy matters"; "At times, he sits in on important policy matters and takes a direct part in the formation of company policy.")

Also in both groups there are elements of dilution in the figures themselves that should be kept in mind when considering the findings. Several of the companies reporting non-participation further indicated that the department was relatively new and as a consequence, the department head was still serving in only a "servicing" capacity. The implication was present in several instances that this condition could change. Another possible dilution of the figures is the possible misinterpretation of the term "directly," as used in the questionnaire; the term may mean different things to different people.

Size of Marketing Research Department

The size of the Marketing Research Department will depend, not so much on the type of product made or the sales volume of the business, as upon some one or all of the following factors:

1. The number of actual marketing research functions it performs.
2. The amount of routine work assigned to the department.
3. The amount of statistical accounting done by the department; i.e., customer sales analysis, area or geographic distribution of sales, sales by item, sales cost distribution, etc.
4. The use of company service departments such as stenographic and computation pools and tabulating departments.
5. The promotional uses made of marketing research findings and other promotional activities assigned the department.
6. The degree of centralization of marketing research activities prevailing in the organization.

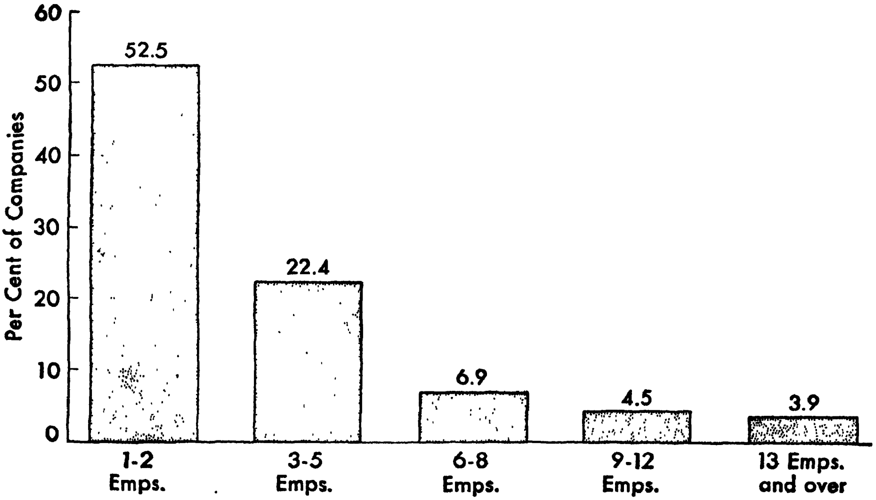

Chart 5. Companies with Research Departments of Various Sizes (9.8 per cent, no answer).

The purpose of the Committee in requesting information on the number of people employed in marketing research was primarily to determine the size of present departments rather than to establish what the size of the department should be, because until all six of the above factors are known, it is impossible to arrive at a standard size for the department and that may well differ for each company studied.

The replies to the questionnaire revealed a substantial proportion of one and two person departments. The largest department reported was in excess of 100 people and that department's functions included some promotional effort and some routine statistical accounting functions.

The over-all percentage of companies with departments of various sizes is as follows:

Number of Employees in Marketing Research Dept.	Number of Companies	Per Cent
1– 2	283	52.5
3– 5	121	22.4
6– 8	37	6.9
9–12	24	4.5
13–15	4	0.7
16–20	7	1.3
Over 20	10	1.9
No answer	53	9.8
Total	539	100.0

The weighted average of the number of employees for companies that gave us a quantitative answer was 3.7. Thus it might be said that the average existing Marketing Research Department consists of about 4 employees. (See Chart 5.) In consumer goods companies the average is 4.1 and in industrial goods companies 3.5 employees.

Size of company, as would be expected, has an important effect upon the size of the Marketing Research Department as the following indicates:

Size of Company	Average Number Employees in Marketing Research Department
Under $500,000 sales	1.8
$500,000–$2,500,000 sales	2.0
$2,500,000–$5,000,000 sales	3.0
Over $5,000,000 sales	5.0
Average of sample	3.7

As pointed out, however, these are not ideal figures to be utilized as standards. The number of employees to be used in the research department must depend on the functions to be performed rather than trying to base the size of the department on the sales volume of the company, its type, or some other factor.

SUMMARY

Approximately 38 per cent of the 4,786 companies responding to the questionnaire reported doing marketing research of some kind, either through an organized department or through a line executive. Size seems to be the determining factor in the establishment of a Marketing Research Department. Relatively few companies with sales under $2,500,000 use established departments for performing research functions.

The channels of distribution have a bearing on the scope of marketing research functions. Where the chain of distribution is relatively direct, fewer companies performed these functions. The product made by the company may be an important factor in determining whether a Marketing Research Department has been organized.

In companies having organized research departments, these departments performed 11 of the functions listed on the questionnaire, on the average, while only 7 of these functions were performed in the other companies engaging in marketing research.

Forecasting sales and determining sales potentials are the two most frequently checked functions among both consumer goods and industrial goods companies with research departments. Companies seem to be more interested in their sales and advertising results than in the best means of attaining those results or of improving them.

Respondent companies showed little uniformity in their selections of the outstanding research jobs they had done. Only three types of jobs stand out to any degree:

1. Studies of market potentials
2. Developing or improving products
3. Studies of product demand

Projects related to product development seem to have been equally valuable to both consumer and industrial companies.

Marketing research activities are considered of sufficient importance in nearly half of the companies to engage the attention of the top management group. Where the marketing research activity has been recognized sufficiently for it to become a separate department, the interest of top management is even more pronounced for 78 per cent of such Marketing Research Department heads report to top executives in management. There appears to be no significant difference between industrial goods companies and consumer goods companies in this respect.

In about one-half of the companies having Marketing Research Departments, these departments participate directly in the determination of company policy. Marketing Research Departments vary greatly in size but the large bulk have less than five employees.

V. EXPENDITURES FOR MARKETING RESEARCH

More interest probably has been evidenced in this portion of our survey than in any other section. Industry itself, as well as marketing research people, have been extremely interested in finding out how much was being spent for marketing research. It is regrettable, however, that this question can be answered only for the sample, and the data are such that they cannot be projected to attempt an estimate of the total dollar expenditures for research in the United States. Such an attempt would certainly end in a rank overstatement of research expenditures.

In the first place, there was found to be considerable reluctance on the part of companies returning questionnaires to give any information in terms of dollars. In order to secure data that would be of value, the Committee, therefore, decided to ask for this information in terms of the percentage of sales volume, believing that information of this kind would be more useful than no information at all on marketing research costs even though it was not projectable data.

To provide some comparative basis for the information on marketing research expenditures, it was decided to ask for similar information on advertising and technical research. It was found, however, that the data on technical research were not as good a comparative guide as those on advertising, and as a result, only the comparisons of marketing research and advertising expenditures are used in this report. Similarly, data were requested as to expenditures in 1940 as well as in 1945 in order to show trends. Because the 1940 data were found to be incomplete and because the Committee considered that trend was the most important aspect of the problem, quantitative measurement of that trend was disregarded for the purpose of this report.

RETICENCE OF COMPANIES ON MARKETING RESEARCH COSTS

A most significant fact developed in this study shows that 44 per cent of those companies with organized departments and 73 per cent of those companies where the activities were a function of a line executive could not or would not give information as to their marketing research expenditures. Of all 1,812 companies doing marketing research, nearly 65 per cent did not answer this question.

It is difficult to understand how nearly half of the companies with established research departments could fail to have information on costs, though in several instances the questionnaire indicated that the department was just being established and costs were not yet available.

Companies where marketing research is a line executive function would appear to have more excuse for having no data on marketing research costs since it would be impossible to arrive at any satisfactory breakdown, for example, of a sales manager's time as between his line function and his research functions.

The large number of respondents in both groups who simply made no attempt to reply, however, indicates that there is a paucity of information regarding marketing research costs that is dangerous, both to the company and to marketing research. Only 39 per cent of the companies responding failed to answer the question about the percentage spent for advertising. If this can be considered the percentage having data but reluctant to answer the question regarding marketing research costs, then a minimum of one-fourth of the companies doing marketing research did not know the costs of their marketing research operation.

AMOUNT SPENT FOR MARKETING RESEARCH

For all companies reporting doing marketing research, the weighted average expenditures for this function and for advertising are shown in the following table, expressed as the percentage of net sales spent for each, as reported by the sample.

1944–45 EXPENDITURES FOR MARKETING RESEARCH AND ADVERTISING IN PER CENT OF NET SALES

Per Cent of Net Sales	Marketing Research		Advertising	
	Number of Companies	Per Cent	Number of Companies	Per Cent
0 – 0.1				
0.1– 0.3	525	29.0	278	15.3
0.3– 0.5				
0.5– 1.0	60	3.3	235	13.0
1.0– 3.0	.....	.....	385	21.3
3.0– 5.0	52	2.9	115	6.4
5.0–10.0	.....	.....	58	3.2
Over 10.0...	.....	.....	37	2.0
No answer..	1,175	64.8	704	38.8
Total.....	1,812	100.0	1,812	100.0

These averages are substantiated by another recent survey on marketing research which showed that the cost of the activity in 154 companies doing research was 0.3 per cent of net sales.[1]

The weighted average cost for the 303 companies with research departments that reported costs was 0.28 per cent of net sales. That for the 335 companies where marketing research is a function of a line executive was 0.29 per cent of net sales. It would seem, therefore, that it costs no more and probably slightly less in terms of per cent of sales to have the marketing research functions performed by an established department than to have such functions performed by line executives and, as was shown earlier, there are fewer marketing research functions performed where a line executive undertakes this work as an incidental assignment. Moreover, there is considerable question whether the functions are performed as well when they are performed by the line executive who is probably not so familiar with marketing research techniques.

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[1] National Industrial Conference Board, *Organization for Market Research, Part I*, 1945, p. 9.

EFFECT OF PRODUCT TYPE AND SIZE OF COMPANY ON EXPENDITURES

There appears to be little difference in the percentages of net sales spent for marketing research as between consumer and industrial goods companies, including both those with organized departments and those where it is a line executive function. The comparison, however, as between industrial and consumer goods companies for marketing research as compared with advertising, is significant:

	Consumer Goods Companies	Industrial Goods Companies
Number of companies	689	1,107
Percentage of net sales for advertising	2.9	1.6
Percentage of net sales for marketing research	0.29	0.28
Percentage of advertising expenditures spent for marketing research	10	18

Naturally, the size of the company plays an important part in the percentage of net sales spent for advertising and for marketing research. The following table shows the weighted average percentage of net sales spent for the two functions by all companies doing marketing research, either through organized departments or as a line executive function, as reported for 1944 or 1945 (see Chart 6 also):

Size—Sales Volume	Percentage of Net Sales Spent for:			
	Market Research	Number Companies Reported	Advertising	Number Companies Reported
Under $500,000	0.37	113	2.62	217
$500,000–$2,500,000	0.32	226	1.94	426
$2,500,000–$5,000,000	0.24	102	1.89	183
Over $5,000,000	0.21	188	1.82	268

As would be expected, the expense percentages for both marketing research and advertising fall as the sales volume rises. But the percentage spent for marketing research declines faster than that spent for advertising, with increasing sales. The marketing research expenditures of the largest companies in terms of percent of sales was only 57 per cent as large as the smaller ones but they spend 70 per cent as large a percentage for advertising.

The question arises as to the significance of these figures. Certainly it cannot be said that this ratio or this level of expenditure for marketing research should be considered as a guide in determining whether one's costs for this function are too high or too low. It is neither a goal nor a criterion. The consensus of opinion of the Committee is that the significance of these figures gives us some clue as to what is being spent for marketing research. The application of these data to a company's operations should be with full knowledge and careful appraisal of the nature of the business, the competition with which it is faced, and the accumulation of experience of the company with markets and marketing problems. Of course, these figures have other valuable uses too. They serve as a rough base line against which future accomplishment can be measured.

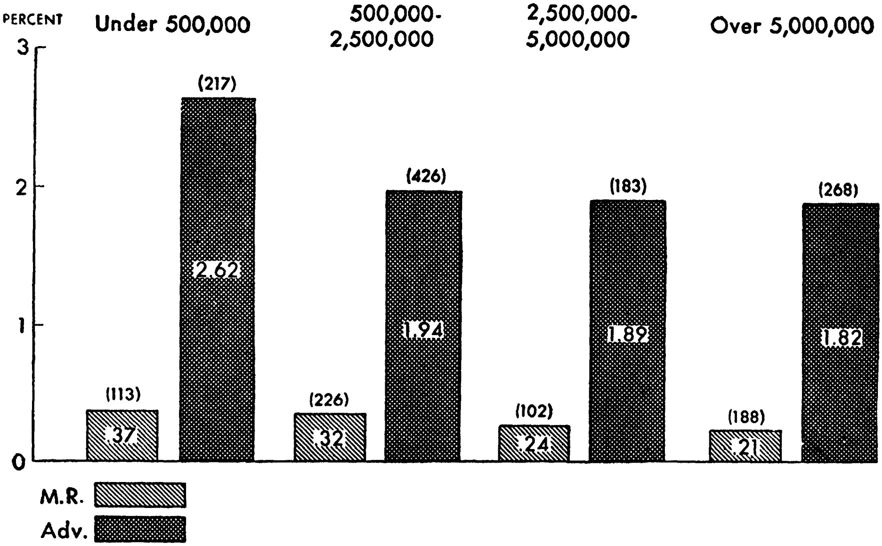

CHART 6. Percentage of Net Sales Spent for Marketing Research and Advertising by Size of Company. (Net sales volume.)

Thus we find that companies selling consumer goods spend slightly more for marketing research and are somewhat more articulate about those costs than companies selling industrial goods. Companies with organized research departments spend about the same relative amount for marketing research as do companies where marketing research is a line executive function. The smaller companies spend more relative to sales and are more articulate about their costs than are larger companies. Thus, while the need for marketing research may increase in proportion to a company's sales growth, it does not necessarily follow that research costs should grow at the same rate.

This might occur up to a certain point—but beyond that point many accumulated efficiencies and economies, such as multiple uses for each completed research undertaking, become effective and retard the upswing of costs.

Study of detailed data comparing companies where marketing research is conducted on an organized department basis and where it is a function of one or more line executives reveals that where the function is departmentalized there is a much clearer knowledge of the costs that are being incurred. Also there are higher percentage levels for marketing research costs that run in excess of one-half of one per cent of net sales as well as costs below one-half of one per cent. Of course, the group with departmentalized research operations contains more of the large companies and as pointed out previously in this section, their research costs per dollar of net sales are smaller than is found among smaller companies.

Relationship between Expenditures for Marketing Research, Advertising and Technical Research

There is a clear and significant relationship between marketing research and advertising. As appears in the following table, expenditures for marketing research are significantly larger in companies having high advertising-sales

Relationship of Marketing Research Expenditures to Advertising Expenditures

(Excluding companies not answering the question)

Marketing Research Expenditures	Spend More than 3 Per Cent for Advertising		Spend Less than 3 Per Cent for Advertising	
	Number of Companies	Per Cent	Number of Companies	Per Cent
0–0.5 per cent	81	64.8	432	87.2
0.5–1.0 per cent	23	18.4	34	6.8
Over 1.0 per cent	21	16.8	30	6.0
Total	125	100.0	496	100.0

Note: Read this table as follows: Of 125 companies that spend more than 3 per cent for advertising, 64.8 per cent spend less than 0.5 per cent for marketing research.

Relationship of Marketing Research Expenditures to Technical Research Expenditures

(Excluding companies not answering the question)

Marketing Research Expenditures	Spend More than 2 Per Cent for Technical Research		Spend Less than 2 Per Cent for Technical Research	
	Number of Companies	Per Cent	Number of Companies	Per Cent
0–0.5 per cent	162	76.0	374	86.0
0.5–1.0 per cent	24	11.2	36	8.3
Over 1.0 per cent	27	12.8	25	5.7
Total	213	100.0	435	100.0

ratios (in excess of 3 per cent) than among those companies with ratios of less than 3 per cent. Directionally, the same relationship exists between marketing research and technical research, but not to the same extent (see second table on page 107).

These relationships do not necessarily result entirely from the size of the company because all of these data are based upon ratios to total sales volume. Rather it is believed that they reflect an aggressiveness and intensiveness of competitive enterprise wherein marketing research is employed as an integrated tool.

CHANGES IN EXPENDITURES FOR MARKETING RESEARCH

Every war has brought many far-reaching changes. World War II was no exception in this respect. Among the many changes we now know of and others that we shall come to accept is the greater dependence of business on research. All forms of research have grown rapidly and among the newest of these is marketing research. The following table presents an "average picture" of what has happened to marketing research during the years 1940 to 1944–45.

	Number of Companies	Per Cent of Total Companies
Increase...........	251	13.8
Decrease...........	98	5.4
No change...........	190	10.5
No answer........	1,273	70.3
Total............	1,812	100.0

It is not necessarily a real picture of the over-all growth of this activity because counterbalancing the number of companies who have found it necessary and valuable to increase marketing research, there are others which found it necessary or expedient to curtail those functions because of war-restricted production, sellers' markets, etc.

In addition, there is the relative nature of the figures themselves. Increasing research expenditures related to more rapidly increasing sales volumes would produce an apparent reduction in the expenditures for marketing research. The net, however, is an appreciable gain and the consensus of the Committee after careful study of the figures is that it is a conservative reflection of the accomplishment that has accrued to the status of marketing research as a business tool during that five-year period.

A study of the detailed data upon which the foregoing table is based reveals that more companies producing industrial goods increased their marketing research expenditure ratio than did companies producing consumer goods. Also more smaller companies increased their ratio than did the larger companies. While the differences in these two comparisons were small, the ratio increases and the extent of articulateness concerning costs was much greater among companies with departmentalized research than among the companies where research responsibility is vested in a line executive.

On the other hand, the detailed data show that more companies have experienced a reduced ratio of advertising to net sales than have increased their ratio. This, of course, is understandable, first, where there has been actual curtailment of advertising by some companies largely or wholly engaged in war production during that period and, secondly, where small increases in advertising have occurred against large increases in sales.

How Marketing Research Budget Is Spent

Among the many questions asked of and by the marketing man in connection with practically every research project undertaken is, "Through what channels is the project to be conducted?" There have been as many answers to this question as there have been surveys conducted and research technicians conducting them. The table below reflects the many degrees of preference for or against each of the several general channels through which survey work may be conducted:

How Marketing Research Expenditures Are Made

Percentage	Spent Directly		Spent through Advertising Agency		Spent through Consultant	
	Number of Companies	Per Cent	Number of Companies	Per Cent	Number of Companies	Per Cent
0– 10	119	6.6	662	36.5	700	38.6
10– 20	28	1.5	36	2.0	28	1.5
20– 30	33	1.8	46	2.5	42	2.3
30– 40	22	1.2	14	0.8	19	1.0
40– 50	94	5.2	53	2.9	48	2.7
50– 60	24	1.3	11	0.6	10	0.5
60– 70	23	1.3	12	0.7	8	0.4
70– 80	84	4.6	19	1.0	19	1.0
80– 90	258	14.2	38	2.1	31	1.7
90–100	426	23.5	209	11.5	219	12.1
No answer...	701	38.8	712	39.4	688	38.2
Total......	1,812	100.0	1,812	100.0	1,812	100.0

Note: Read this table as follows: Of the 1,812 companies reporting marketing research expenditures, 23.5 per cent spend 90 per cent of their budget directly, 36.5 per cent spend 0–10 per cent of their budget through advertising agencies, and 38.6 per cent spend 0–10 per cent through consultants.

It is obvious that among those companies answering the question there is a preference for direct spending and control rather than employing the facilities of an advertising agency or marketing research consultant. Study of this table indicates that approximately one-third of the companies do most of their own research, another one-third are about evenly divided between the employment of advertising agencies and marketing research consultants and the remaining one-third are not inclined to answer the question.

VI. FUTURE OF MARKETING RESEARCH

Probably one of the most encouraging facts developed by this study was that industry has apparently recognized the value of marketing research and its contribution to past success, particularly where an organized department was established in the organization. Where marketing research was a function of a line executive, there was less favorable reaction, i.e., intention to organize a department, and where companies did no marketing research, there was even less favorable reaction. (See Chart 7.)

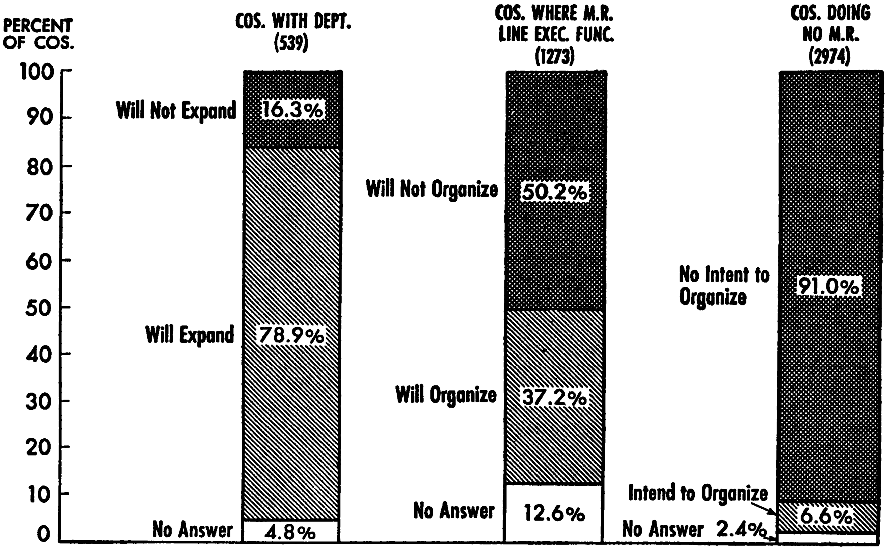

CHART 7. Future of Marketing Research.

This speaks well of the results that companies with experience have had with their research departments and certainly should supply food for thought for those companies which do not now have research departments. This is particularly true of companies whose sales volume exceeds 2½ million dollars and whose market is not confined to a very limited number of outlets, whether those companies are producing consumer goods or industrial products.

FUTURE OF ESTABLISHED RESEARCH DEPARTMENTS

Of the 539 companies with established research departments nearly 80 per cent said that they intended to expand that department, either in scope or intensity of effort.

No data were available from our survey as to the extent of the intended expansion, though it would have been interesting information.

These companies have had experience with the marketing research activity, and a great proportion recognize the value of its contributions and have expressed themselves favorably, as far as the future of research in their business is concerned.

INTENTION TO EXPAND MARKETING RESEARCH DEPARTMENT

	Number of Companies	Per Cent
Will expand	425	78.9
Will not expand	88	16.3
No answer	26	4.8
Total	539	100.0

There is little difference between consumer goods companies and industrial goods companies in regard to their intention to expand. There is, however, a decided tendency for greater expansion among the larger companies. The difference, however, is less than might be expected, particularly as between the smallest and largest group. Probably, the smaller companies recognize the use of marketing research as one means of soundly increasing their sales volume.

INTENTION TO ORGANIZE A MARKETING RESEARCH DEPARTMENT IN COMPANIES WHERE IT IS NOW A LINE EXECUTIVE FUNCTION

The group of 1,273 companies in which marketing research activities are a function of a line executive appear to be much less favorably impressed with marketing research, although it should be pointed out that intention to expand an existing department is considerably different from the intention to organize a separate department. It may be that the organizational set-up precludes centralizing the functions in many of these companies or that in many of them restricted distribution functions make centralized marketing research impracticable.

The difference between the favorable reaction of this group as compared with those who have organized departments, however, is too large to be accounted for solely by these reasons. The following table shows the intention of the companies in this group to organize departments:

COMPANIES WHERE MARKETING RESEARCH IS A LINE EXECUTIVE FUNCTION—INTENTION TO ORGANIZE MARKETING RESEARCH DEPARTMENTS

	Number of Companies	Per Cent
Intend to organize	473	37.2
No intention	639	50.2
No answer	161	12.6
Total	1,273	100.0

If we can be allowed to speculate on the reason that these companies seem to be less favorably impressed with marketing research, we can draw on the facts presented previously that marketing research functions are performed where it is a line executive's duties and that the costs are approximately the same whether they are performed by an organized department or a line executive. Probably, however, the quality of the work done plays an even greater part in this attitude.

One can hardly expect the same thoroughness, attention to detail and employment of sound techniques in marketing research performed (and therefore the same degree of success) by a busy sales manager or vice president in charge of sales whose principal responsibility is the inspiration and direction of a large sales force, as when that work is performed by a trained, experienced marketing research director who is completely familiar with techniques and sources, and is trained in the method of analyzing and presenting the material.

The detail of marketing research, time required for thorough analysis and selection of facts, and the need for constant checking and rechecking of findings with all known data make it almost impossible for the busy sales executive to do the kind of research that impresses the need for expansion of the research activity on the top management of the company.

Again, the type of company seems to make little difference in the intention to organize a department, but there is evidence that a larger share of the large companies in this group plan to organize departments than is the case for the smaller companies. More than half of the companies with sales of $5,000,000 or more, who answered the question, intend to organize their research function into a centralized department, while less than one-third of the smallest group and about 45 per cent of the second smallest group intend to do so.

ATTITUDE OF THOSE COMPANIES DOING NO MARKETING RESEARCH

This group of 2,974 companies have had no experience with marketing research or do not recognize that they have had such experience. It is among this group, particularly the larger companies, that much educational work should be done in showing the need for, and the results that could be expected from, research. The establishment of Marketing Research Departments in these companies could contribute toward more efficient and more progressive company operation and particularly in the evaluation of sales and advertising opportunities and the measurement of results.

It is only natural that, knowing or recognizing little of the value of marketing research, these companies should express little interest toward organizing the activity in their operation, as is indicated in the table on page 113.

But even in this group of respondents, more detailed analysis shows that 10 per cent of the largest group and nearly 9 per cent of the second largest expressed their intention of organizing a Marketing Research Department.

If the intentions of those reporting no marketing research and those in companies where it is a line executive function are carried out, the percentage of companies with organized departments in our sample would increase from 539 or 11.3 per cent of the total to more than 1,200 or approximately 25 per cent of the total sample. That is, on this basis alone, the number of research departments would more than double.

The material from our survey certainly indicates a very rapid and substantial increase in the amount of marketing research that will be done in the near future. This, of course, is optimistic but if carried out it should certainly result in better selling and larger profit margins for those companies that expand their activities.

COMPANIES DOING NO MARKETING RESEARCH:
INTENTION TO ORGANIZE MARKETING RESEARCH DEPARTMENTS

	Number of Companies	Per Cent
Intend to organize..	196	6.6
No intention.......	2,706	91.0
No answer.........	72	2.4
Total............	2,974	100.0

There were many interesting comments from the questionnaires on the future of marketing research in the individual businesses of respondents. These are, of course, impossible to condense, but these may be classified as follows:

The first group includes those from respondents who are definitely favorable to the future of marketing research. The second group are those from respondents who are undecided about the future of marketing research as applied to their own situations. The third group of comments is from those who feel that while marketing research will prove of some value in their future operations, it has only a limited application in their particular business. The fourth group is representative of individuals who are somewhat more pessimistic concerning the future of marketing research, or, put differently, they are perhaps overly optimistic as to their ability to carry on successfully without the use of marketing research. Even the respondents whose replies fall into the latter group cannot be said to be antagonistic toward marketing research as such; rather, they feel they can get along without it, in the immediate future at least.

VII. OBSERVATIONS AND RECOMMENDATIONS OF THE COMMITTEE

As in any research project of this kind, there were many comments and observations made by respondents that were impossible of tabulation and, in many cases, not pertinent to the subjects covered by our questionnaire. The Committee feels that many of these should be reflected in the report even without supporting data. Moreover, in handling the mass of data on which the report is based, the Committee observed several conditions that it believes should be recognized in some manner, and these observations and comments are reported here for consideration in respect to the future of marketing research operations. While they lack supporting statistical data they are nonetheless important since they are based upon respondent reaction.

Confusion Regarding the Term "Marketing Research"

Many of the responding companies that stated they did marketing research and reported only one person in the research department, checked only a few of the sixteen functions, usually those covering appraisal of sales opportunities and measurement of sales results.

Strictly speaking, these are not truly Marketing Research Departments yet they had to be so classified for our tabulation. These are really sales statistical operations and while they perform marketing research functions, a department doing only this work should properly be called a Sales Statistical Department. In the opinion of the Committee, the use of the name "Marketing Research" to cover purely sales statistical functions reflects on marketing research as a broad-gauge management tool and is likely to fix in the minds of top executives a very low limitation on the number of functions that the Marketing Research Department should perform as well as on the value of those functions to the organization.

Thoroughness of Performing Marketing Research Functions

Some of the respondents who reported marketing research performed by a line executive checked so many of the sixteen marketing research functions that the question of the thoroughness with which those functions are performed is raised.

Undoubtedly, in many of these cases a sales manager or other line executive who was reported as doing marketing research considered that he was establishing sales potentials or setting quotas, for example, by taking some preconceived figure and breaking it down to his sales territories. This can hardly be called sound quota setting or potential determination, yet it probably is all that the busy operating executive has time to do.

In several cases where a line executive was doing marketing research, the price and demand study functions, among others, were indicated. Because of the time required for such studies and the difficulty of arriving at sound conclusions, it would appear that the executive considered that he performed such functions when he talked to other manufacturers and to wholesalers and retailers regarding demand for his product and price changes.

Such use of the terms describing these functions is regrettable and in the opinion of the Committee some means should be found to differentiate between superficial performance of functions without scientific basis and the thoroughness and scientific approach with which the true marketing research functions of this character are performed.

Place of Marketing Research and Functions Performed

It was very noticeable that not only were the number of functions performed much larger where the Marketing Research Department was responsible to the chief executive of the organization, but also the research person more often participated in the formation of company policy. Furthermore, the comments as to the future of research and the most valuable job done indicated that the department so located had more stature in the organization than did departments located under executives of a lower level.

It was not noticeable, however, that in some of these instances where the research department reported to the chief executive it did not perform all of the functions that had to do with the sales department. Moreover, in the few cases where the department head reported to the advertising executive, functions having to do with sales were not frequently performed.

These observations tend to convince the Committee that the research operation can be of its most complete use only when it reports to top management. Placing the department elsewhere in the organization restricts its usefulness and may even destroy its objective approach to the problems it must help to solve.

Acceptance of Marketing Research by Line Executives

Some evidence appeared in the comments that line executives in a few companies, instead of welcoming help from the Marketing Research Department, actually resented any effort to analyze the possibilities and results of these departments.

This was especially true where the department reported to executives of the same level but in a different line of responsibility. Probably it accounts for the fact that many of the departments reported fewer functions performed than would normally be expected, from the information given.

No doubt in some of these cases the research director himself was to blame in that he had not completely sold himself and his activity to all the executives of the company. On the other hand, there were no doubt many cases where interdepartmental jealousy and closed-mindedness on the part of operating department heads made it impossible for the research department to deliver all the value of which it was capable.

Qualifications of Research Personnel

In a few cases respondents stated that research departments had been discontinued because they had not contributed sufficiently to the operation of the company to be considered as an asset. In one or two cases where the reasons for the failure of the department was apparent from the comments it was evident that the director had not been qualified for his job.

In one case a salesman had been given charge of the operation. It may be assumed that the reason for his failure was that he had, during his entire selling career, been trained to think in a manner diametrically opposed to the objective approach required for research. He was probably not well trained in research techniques or in statistics, and he did not recognize the opportunities for research in departments of the business, other than the sales department.

In the second case in which any clues were given as to the reason for the failure of the department the man chosen was directly out of college, without training either in selling or in marketing research practice. He had been completely theoretical in his approach to problems and had failed to realize that his theoretical training was insufficient foundation for the responsibility of a research director's job.

The Committee feels that much could be done to improve marketing research in industrial organizations if top management would be more selective in its choice of research department heads. It also feels that the American Marketing Association owes assistance to industry in defining the qualifications required in research personnel, if not in actually rating the individual.

Other comments were made by respondents in answer to the question regarding how the marketing research budget was spent that reflected on research personnel. In one case the writer said that the consulting organization hired to do a particular job had failed utterly because he had not taken time to get background material from the company necessary in the study. In another case a consultant was reported to have brought in answers designed to please the organization rather than the facts based on sound research.

The comments may or may not have been true statements, and the reasons for the remarks may have been unsound. On the other hand, marketing research, particularly consultants, faces a real challenge here. The Committee believes that there is a danger to marketing research in the increasing number of consultant organizations springing up in the larger cities, many of whose members have neither the academic background nor the experience to do consulting work in marketing research.

It is the opinion of the Committee that the marketing research consultants should take steps to set up some means of qualifying newcomers in the field, similar to those used by other semi-professional consulting groups. This would be of real value to those executives in industry who are not familiar with the consulting profession but who must depend upon them for their marketing research activities.

Recommendations to Executives for Marketing Research within Their Organization

So many executives, who responded to the questionnaire, requested help in setting up a research department within their organization that the Committee is of the opinion that it would be of considerable value if this report were to contain some recommendations and suggestions for those companies who intend to establish such operations. The following are general suggestions of the Committee that it is hoped will be of real value. It must be said that they are probably biased since they stem from research men and, of course, cannot consider the individual conditions that exist in particular companies.

1. Select the department head carefully. He should have all or most of these qualifications:

a. Academic training in economics, marketing, statistics and business organization.
b. Objective thought habits and keen analytical ability.
c. Uncompromising intellectual honesty.
d. Ability to get along with people even when they disagree violently with his conclusions.
e. Experience in marketing research and in selling or advertising.

2. Place the department in the organization so that it is free to report its conclusions without bias. The Committee feels that properly it should report to the president but it should normally never report to an executive lower than a vice president.

3. Determine a long range program for the department, subject, of course, to revision necessitated by changes in conditions that face the company; and agree on the precedence and emphasis for particular parts of the program.

4. Set the budget and personnel complement for the department on the basis of the program. Remember that such a budget must be flexible and that the cost of the research must be kept in line with its probable value. If the value to be derived from a project increases, increase the budget.

5. Give the research department head a discretionary budget. With it, he may be able to discover economies, sales and advertising methods, and other data that will save much more than the entire departmental budget. He might not be able to get an appropriation passed for such an investigation. Timing is of extreme importance in many research projects.

6. Demand a statement on each part of the program showing:

a. Purpose
b. Method
c. Limitations of the job
d. Cost of the job

Demand progress reports at stated intervals.

7. Make your research man a member of all sales, advertising and product committees. He cannot anticipate the need for research or suggest its most effective use unless he knows all of the problems facing the company and the company plans.

8. If the department does not or cannot perform all of the sixteen functions listed that you think it should, find out why. Perhaps line executives are not participating properly and are restricting the scope of the research work. Perhaps your director is not qualified to perform all of them.

9. Do not expect a research man to spend all his time in the office. Swivel chair research is dangerous and the conscientious research man will and must travel in the field. He must contact others in the research field for new ideas and new sources of data.

VIII. Summary

Forty-four per cent of those companies with organized departments and 74 per cent of those companies where the activities were a function of a line executive could not or would not give information as to their marketing research expenditures. Of all 1,812 companies doing marketing research, nearly 65 per cent did not answer this question.

The weighted average cost for the 303 companies with research departments that reported costs was 0.28 per cent of net sales. That for the 335 companies where marketing research is a function of a line executive that reported costs was 0.29 per cent of net sales. The percentages spent for both marketing research and advertising fall as the sales volume rises.

One-third of the companies say they do their own research, another third were about evenly divided between the employment of advertising agencies and marketing research consultants, and the remaining third did not answer the question.

Of the 539 companies with established research departments nearly 80 per cent said that they intended to expand these departments. The tendency toward greater expansion is more marked among the larger companies. More than half of the companies with sales of $5,000,000 or more, who answered the question and who do not now have a centralized department, intend to organize one. If these intentions are carried out, the percentage of companies with organized departments in our samples would increase from 539 (or 11.3 per cent) of the total to 1,206 (or more than 25 per cent). That is, the number of research departments would more than double.

On a basis of all the findings in the study certain rather definite recommendations can be made with respect to the organization, staffing and use of the Marketing Research Department, which are set forth in detail immediately preceding this summary.

III. MERCHANDISING

SELECTED DATA ON DEMAND

[The extent and variety of information in published form describing the consuming public and industrial buyers are sizable and growing. The following exhibits are designed to illustrate some of the more common and more easily obtainable types of data. They are samples only, and in all instances are excerpts from the indicated publications rather than complete reproductions.]

Exhibit 1

[The *Consumer Market Data Handbook* has been published by the U.S. Bureau of Foreign and Domestic Commerce in 1929, 1932, 1936, and 1939. A new issue is expected to appear as soon as postwar census data are available.

The following excerpts are a sample of the information available for the United States as a whole and by states, counties, and cities.]

	United States Summary			Massachusetts (Middlesex County)		
	United States	Alabama	Arizona	County	Cambridge	Somerville
Population and Dwellings, 1930:						
1 Persons, total no. (thousands)	122,775.0	2,646.2	435.6	934.9	113.6	103.9
2 Percent white	89	64	61	99	95	100
3 Percent of U.S. total	100.0000	2.1554	.3548	.7615	.0926	.0846
4 Families, total no. (thousands)	29,904.7	591.6	106.0	224.3	27.4	25.5
5 Percent owning homes	48	34	45	47	24	33
6 Dwellings, total no. (thousands)	25,205.0	554.6	98.6	165.8	15.0	14.2
Volume and Type of Business and Industry, 1935:						
7 Retailing, total no. of stores	1,653,961	22,167	5,214	10,189	1,372	1,038
8 Sales (million dollars)	33,161.28	337.22	121.08	251.61	39.11	22.54
9 Percent of U.S. total	100.0000	1.0169	.3651	.7588	.1179	.0680
10 Sales per capita (dollars)	270	127	278	269	344	217
11 Wholesaling, total no. of establishments	176,756	1,668	541	430	113	54
12 Sales (million dollars)	42,802.91	304.55	78.05	112.46	49.56	14.74
13 Manufacturing, total no. of plants	169,111	1,730	279	1,484	352	117
14 Value of products (million dollars)	45,759.76	364.31	55.93	458.72	116.77	78.80
15 Farms, total no.	6,812,350	273,455	18,824	4,862		
Employment and Payrolls, 1935:						
16 Total employees (censuses of business and industry) no.	17,603,219	209,854	37,369	141,538		
17 Wages paid, total amount (thousand dollars)	20,424,969	165,129	40,257	163,774		
18 Retailing, no. of employees	3,961,478	42,517	13,156	30,875	5,346	2,783
19 Wages paid (thousand dollars)	3,623,289	30,360	12,530	28,644	5,035	2,509

20	Wholesaling, no. of employees	1,260,553	10,675	2,670	4,800	1,944	811
21	Wages paid (thousand dollars)	2,022,262	14,201	3,922	7,739	3,407	1,291
22	Manufacturing, no. of employees	7,378,845	97,710	4,965	77,641	16,665	5,825
23	Wages paid (thousand dollars)	7,544,338	64,884	5,321	79,454	17,561	7,128
24	Mining, no. of employees	713,729	21,593	6,769	331		
25	Wages paid (thousand dollars)	739,066	15,357	7,787	495		
26	Farming, no. of persons on farms	31,800,907	1,386,074	100,083	22,694		
27	Gainfully employed, 1930 (thousand persons)	48,832.6	1,026.3	165.3	390.1	51.3	44.3
28	Unemployed, no. reporting, 1937	5,833,401	149,778	13,069	47,220	5,969	5,062
Retail	Distribution by Kinds of Business, 1935:						
29	Food stores, no.	532,010	7,485	1,350	4,278	573	527
30	Sales (thousand dollars)	8,362,425	74,814	25,313	97,836	11,721	10,254
31	Index of place in local sales (place in U.S. = 100)	100	88	83	155	119	180
32	Eating and drinking places, no.	251,473	2,190	938	1,138	211	94
33	Sales (thousand dollars)	2,390,860	12,405	9,066	18,038	4,793	1,741
34	Index of place in local sales (place in U.S. = 100)	100	51	104	99	170	107
35	General stores (with food), no.	66,701	3,138	218	46	3	6
36	Sales (thousand dollars)	1,110,403	48,617	7,891	415	6	39
37	Index of place in local sales (place in U.S. = 100)	100	430	195	5	1	5
38	General merchandise group, no. of stores	44,651	788	144	281	31	28
39	Sales (thousand dollars)	4,619,751	43,548	18,323	21,257	5,110	1,734
40	Index of place in local sales (place in U.S. = 100)	100	93	109	61	94	55
41	Apparel group, no. of stores	95,968	722	190	561	82	49
42	Sales (thousand dollars)	2,656,242	19,783	4,129	11,529	2,218	851
43	Index of place in local sales (place in U.S. = 100)	100	73	43	57	71	47
44	Automotive group, no. of dealers and garages	116,702	1,282	471	733	102	61
45	Sales (thousand dollars)	4,606,650	51,772	21,980	26,829	3,202	1,204
46	Index of place in local sales (place in U.S. = 100)	100	111	131	77	59	38
47	Filling stations, no.	197,568	3,052	827	970	82	65
48	Sales (thousand dollars)	1,967,714	21,439	8,513	15,564	2,443	1,303
49	Index of place in local sales (place in U.S. = 100)	100	107	119	104	105	97
50	Furniture-household group, no. of stores	45,215	554	126	252	38	17
51	Sales (thousand dollars)	1,289,896	14,876	3,814	6,785	1,364	489
52	Index of place in local sales (place in U.S. = 100)	100	113	81	69	90	56
53	Lumber-building-hardware group, no. of stores	73,186	551	170	357	48	31
54	Sales (thousand dollars)	1,864,275	15,480	8,421	12,027	2,079	614
55	Index of place in local sales (place in U.S. = 100)	100	82	124	85	95	48
56	Drug stores, no.	56,697	836	190	453	64	46
57	Sales (thousand dollars)	1,232,593	14,882	5,575	10,394	1,522	1,042
58	Index of place in local sales (place in U.S. = 100)	100	119	124	111	105	124

EXHIBIT 1 (*Continued*)

	United States Summary			Massachusetts (Middlesex County)		
	United States	Alabama	Arizona	County	Cambridge	Somerville
59 Other retail stores, no.	173,790	1,569	590	1,120	138	114
60 Sales (thousand dollars)	3,060,467	19,601	8,058	30,939	4,653	3,272
Related Indicators of Consumer Purchasing Power:						
61 Individual income tax returns, 1934, total no.	4,001,828	22,548	11,792	63,891	7,898	5,031
62 Net incomes below $1,000, no.	410,045	2,206	1,494	6,466	716	485
63 Net incomes $1,000–$3,000, no.	2,477,375	13,357	7,323	40,422	5,301	4,002
64 Net incomes $3,000–$5,000, no.	728,439	4,740	2,297	10,319	1,035	422
65 Net incomes $5,000–$10,000, no.	271,392	1,719	562	4,696	583	98
66 Net incomes above $10,000, no.	114,577	526	116	1,988	263	24
67 Individual income tax returns, 1935, total no.	4,648,784	26,370	14,330	68,083	8,614	5,534
68 No. per 1,000 persons	38	10	33	73	76	53
69 Passenger automobiles registered, 1936, no.	22,295,072	212,867	86,866	161,899		
70 No. per 100 families	75	36	82	72		
71 Families with radios, 1938, total no.	26,666,500	375,200	79,600	223,760		
72 No. per 100 families	89	63	75	100		
73 Residential telephones, 1935, total no.	10,718,626	60,974	19,697	125,037		
74 No. per 100 families	36	10	19	56		
75 Domestic electric meters, 1930, total no.	20,049,450	149,854	54,269	204,164	27,813	23,115
76 No. per 100 families	67	25	51	91	101	91
77 Circulation of 12 national magazines, 1937	27,975,238	259,841	121,864	137,072	*	*
78 No. per 100 families	94	44	115	61	*	*
79 Circulation of 6 general magazines, 1937	12,500,172	113,810	61,829	59,569	*	*
80 Circulation of 6 women's magazines, 1937	15,475,066	146,031	60,035	77,503	*	*
81 Farms, 1935, value (thousand dollars)	32,858,844	368,220	132,650	43,956		
82 Value per farm (dollars)	4,823	1,347	7,047	9,041		

* Magazine circulation data for Cambridge and Somerville included in Boston (Suffolk County).

Source: Adapted from U.S. Bureau of Foreign and Domestic Commerce, Domestic Commerce Series No. 102, *Consumer Market Data Handbook* (Washington, D.C., U.S. Government Printing Office, 1939), pp. 2, 176.

EXHIBIT 2

[The *Survey of Current Business* has been published monthly since August, 1921, by the U.S. Bureau of Foreign and Domestic Commerce. In addition to a discussion of the current business situation and two or three articles on some aspect of the national or international economy, it carries a section of detailed statistical data for the United States as a whole, including business activity, prices, employment conditions and wages, finance, foreign trade, and production, consumption, and stocks of selected commodity groups.

The following tables are excerpts from the section on monthly business statistics. Several footnotes relating to revisions in series or the source of earlier data have been omitted.]

BUSINESS INDEXES

Unless otherwise stated, statistics through 1941 and descriptive notes may be found in the 1942 Supplement to the Survey	1947						
	January	February	March	April	May	June	July
Personal income (billions of dollars):							
Seasonally adjusted, at annual rates:							
Total personal income	190.3	190.7	191.8	190.2	191.5	195.1 *	196.9
Wage and salary receipts, total	117.1	117.5	117.5	116.7	118.3	121.1 *	121.5
Total employer disbursements	119.2	119.6	119.6	118.9	120.4	123.2 *	123.6
Commodity-producing industries	53.1	53.2	53.7	53.2	54.1	55.5 *	55.4
Distributive industries	33.5	33.7	33.7	33.4	34.2	35.3 *	35.7
Service industries	14.6	14.6	14.6	14.8	14.9	15.2 *	15.3
Government	18.0	18.1	17.6	17.5	17.2	17.2 *	17.2
Less employee contributions for social insurance	2.1	2.1	2.1	2.2	2.1	2.1	2.1
Other labor income	1.6	1.7	1.7	1.7	1.8	1.8	1.8
Proprietors' and rental income	46.6	46.8	47.7	46.9	46.9	47.6 *	48.2
Personal interest income and dividends	13.9	14.0	14.0	14.0	14.0	14.1 *	14.3
Total transfer payments	11.1	10.7	10.9	10.9	10.5	10.5 *	11.1
Total nonagricultural income	168.2	168.5	168.8	167.8	169.2	171.9 *	173.0
Farm marketings and income:							
Farm marketings, volume (1935–1939 = 100):							
Indexes, unadjusted:							
Total farm marketings	144	112	118	119	127	138	167
Crops	149	93	91	85	86	105 *	180
Livestock and products	140	127	138	144	158	163	158
Indexes, adjusted:							
Total farm marketings	166	148	145	141	†	†	†
Crops	191	148	148	141	†	†	†
Livestock and products	148	148	143	141	†	†	†
Cash farm income, total, including Government payments (millions of dollars)	2,180	1,745	1,996	1,972	2,033 *	2,215	2,687
Income from marketings	2,144	1,701	1,930	1,912	1,996	2,192	1,226
Crops	834	522	608	582	614	743	1,461
Livestock and products	1,310	1,179	1,322	1,330	1,382	1,449	377
Dairy products	320	314	337	347	383	388 *	798
Meat animals	811	686	754	736	716	794	252
Poultry and eggs	174	174	225	233	260	233 *	
Indexes of cash income from marketings (1935–1939 = 100):							
Crops and livestock, combined index:							
Unadjusted	323	256	291	288	300	330 *	404
Adjusted	366	352	364	367	†	†	†
Crops	370	310	338	364	†	†	†
Livestock and products	364	384	383	369	†	†	†

* Revised. † Discontinued.

EXHIBIT 2 (*Continued*)

COMMODITY PRICES

Unless otherwise stated, statistics through 1941 and descriptive notes may be found in the 1942 Supplement to the Survey	1947						
	January	February	March	April	May	June	July
Retail prices:							
Consumers' price index:							
National Industrial Conference Board:							
Combined index (1923 = 100)	.....	.....	124.9				
Clothing	.....	.....	108.3				
Food	.....	.....	152.3				
Fuel and light	.....	.....	101.5				
Housing	.....	.....	91.0				
Sundries	.....	.....	126.9				
U.S. Department of Labor:							
Combined index (1935–1939 = 100)	153.3	153.2	156.3	156.2 *	156.0 *	157.1	
Clothing	179.0	181.5	184.3	184.9 *	185.0 *	185.7	
Food	183.8	182.3	189.5	188.0	187.6	190.5	193.1
Cereals and bakery products	143.4	144.1	148.1	153.4	154.2	154.6	155.0
Dairy products	190.1	183.2	187.5	178.9	171.5	171.5	178.8
Fruits and vegetables	187.9	191.7	199.6	200.4	207.0	205.0	202.0
Meats	199.0	196.7	207.6	202.6	203.9	216.9	220.2
Fuel, electricity, and ice	117.3	117.5	117.6	118.4	117.7 *	117.7	
Gas and electricity	91.9	92.2	92.2	92.5	92.4	91.7	
Other fuels and ice	142.1	142.3	142.5	143.8 *	142.4	143.0	
Housefurnishings	179.1	180.8	182.3	182.5 *	181.9 *	182.6	
Rent †	108.8	108.9	109.0	109.0	109.2	109.2	
Miscellaneous	137.1	137.4	138.2	139.2 *	139.0 *	139.1	
U.S. Department of Commerce index:							
All commodities (1935–1939 = 100)	172.7	172.7	177.2	177.2	177.1	178.7 *	
U.S. Department of Labor indexes (1923–1925 = 100):							
Anthracite	121.6	121.6	121.6	121.5	116.8	116.8	119.2
Bituminous coal	121.9	122.2	122.3	122.5	123.4	123.6	129.5
Fairchild's index:							
Combined index (Dec. 31, 1930 = 100)	122.1	122.9	123.5	123.9	123.8	123.7	124.1
Apparel:							
Infants'	118.4	120.0	120.9	121.2	121.8	121.7	122.0
Men's	117.7	119.3	121.1	121.5	121.5	121.4	121.7
Women's	119.5	120.1	120.2	120.6	120.6	120.4	120.6
Home furnishings	127.9	129.1	129.9	130.4	130.5	130.7	131.2
Piece goods	117.5	120.2	121.4	120.5	120.0	120.1	120.4
Wholesale prices:							
U.S. Department of Labor indexes:							
Combined index (889 series) (1926 = 100)	141.5	144.5	149.5	147.7	147.1 *	148.0 *	150.8
Economic classes:							
Manufactured products	136.7	139.7	143.3	141.9	141.7	142.3	144.7
Raw materials	152.1	154.9	163.2	160.1	158.6	160.2	164.7
Semimanufactured articles	138.8	142.1	145.9	144.5	144.9	145.9 *	147.0
Farm products	165.0	170.4	182.6	177.0	175.7	177.9	181.4
Grains	162.6	171.1	203.3	199.8	202.4	206.0	202.3
Livestock and poultry	189.6	201.5	216.0	199.2	198.7	200.9	202.9
Commodities other than farm products	136.1	138.6	142.1	141.0	140.6 *	141.2 *	143.9
Foods	156.2	162.0	167.6	162.4	159.8	161.8	167.1
Cereal products	139.9	141.3	150.4	154.1	151.7	149.2	154.7
Dairy products	164.6	161.8	157.6	148.8	138.8	140.9	152.8
Fruits and vegetables	131.6	134.2	141.5	142.2	144.3	145.2	139.7
Meats	183.4	199.5	207.3	196.7	203.0	208.6	217.9
Commodities other than farm products and foods	127.6	128.5	131.1	131.8	131.9 *	132.0 *	133.8
Building materials	169.7	174.8	177.5	178.8	177.0	175.2	176.5
Brick and tile	132.2	132.3	132.4	134.5	134.5	134.7	143.3
Cement	108.3	109.9	112.3	114.0	114.0	114.3	114.9
Lumber	249.9	263.6	269.3	273.5	269.4	266.1	269.0
Paint and paint materials	171.2	173.9	176.1	175.5	169.2	163.9	160.4
Purchasing power of the dollar (1935–1939 = 100):							
As measured by:							
Wholesale prices	56.9	55.7	53.8	54.5	54.7 *	54.4 *	53.3
Consumers' prices	65.2	65.3	64.0	64.0 *	64.1 *	63.6	
Retail food prices	54.3	54.8	52.7	53.1	53.2	52.4	51.7
Prices received by farmers	41.0	40.7	38.0	38.5	39.2	39.3	38.5

* Revised.

† Data for 1947 are estimated, based on a survey of rents in five cities in January and six in February to July.

EXHIBIT 2 (*Continued*)

DOMESTIC TRADE

Unless otherwise stated, statistics through 1941 and descriptive notes may be found in the 1942 Supplement to the Survey	1947						
	January	February	March	April	May	June	July
Retail trade:							
All retail stores:							
Estimated sales, total (millions of dollars)	7,838	7,464	8,746	8,822	9,280	8,864	8,566
Durable goods stores	1,620	1,584	1,860	1,988	2,102	2,078	2,071
Automotive group	696	681	799	828	835	833	854
Motor vehicles	589	582	683	710	706	703	720
Parts and accessories	107	99	116	118	129	130	134
Building materials and hardware	476	460	552	635	674	669	690
Building materials	304	293	343	394	414	425	450
Farm implements	51	50	66	78	79	77	77
Hardware	120	117	143	164	182	167	162
Homefurnishings group	377	373	429	444	496	480	450
Furniture and housefurnishings	240	240	283	293	331	314	284
Household appliance and radios	137	132	146	150	164	166	166
Jewelry stores	71	71	79	81	97	96	77
Nondurable goods stores	6,218	5,880	6,886	6,834	7,178	6,686	6,496
Apparel group	610	549	806	775	786	718	568
Men's clothing and furnishings	145	133	192	185	194	194	137
Women's apparel and accessories	280	250	375	352	348	295	245
Family and other apparel	88	78	108	101	104	97	79
Shoes	98	88	131	137	139	132	108
Drug stores	286	275	302	289	303	288	290
Eating and drinking places	961	861	960	978	1,036	996	1,014
Food group	2,213	2,098	2,317	2,302	2,478	2,272	2,332
Grocery and combination	1,707	1,632	1,812	1,786	1,942	1,770	1,823
Other food	506	467	505	516	536	502	509
Filling stations	304	282	314	327	346	340	361
General merchandise group	995	973	1,247	1,260	1,305	1,200	1,077
Department, including mail order	656	639	842	834	857	788	675
General, including general merchandise with food	124	120	142	151	165	153	155
Other general merchandise and dry goods	100	97	123	126	136	125	115
Variety	116	117	141	149	147	134	133
Other retail stores	848	842	941	902	923	872 *	854
Feed and farm supply	204	209	252	270	259	237	239
Fuel and ice	202	203	192	138	132	137	135
Liquors	143	140	157	147	154	136 *	139
Other	299	291	341	348	379	361	342
Indexes of sales (1935–1939 = 100):							
Unadjusted, combined index	241.3	250.1	265.1	275.4	279.5	279.9 *	262.8
Durable goods stores	201.2	214.6	230.6	249.8	260.8	267.8 *	257.1
Nondurable goods stores	254.4	261.7	276.4	283.7	285.6	283.8	264.7
Adjusted, combined index	276.2	280.6	277.6	274.2	274.1	275.4 *	275.4
Wholesale trade:							
Service and limited function wholesalers:							
Estimated sales, total (millions of dollars)	5,109	4,732	4,996	4,977	4,952 *	4,844 *	4,981
Durable goods establishments	1,583	1,599	1,736	1,818	1,763	1,700	1,637
Nondurable goods establishments	3,526	3,133	3,260	3,159	3,189 *	3,144 *	3,344
All wholesalers, estimated inventories (millions of dollars)	6,271	6,514	6,729	6,823	6,734	6,755	6,660

* Revised.

EXHIBIT 2 (*Continued*)

EMPLOYMENT CONDITIONS AND WAGES

Unless otherwise stated, statistics through 1941 and descriptive notes may be found in the 1942 Supplement to the Survey	1947						
	January	February	March	April	May	June	July
Labor conditions:							
Average weekly hours per worker:							
Natl. Indus. Conf. Bd. (25 mfg. industries)	40.8	40.8	40.6	40.5	40.4	40.3	
U.S. Dept. of Labor, all manufacturing	40.6	40.4	40.4	40.0	40.1	40.3 *	39.9 †
Durable goods industries	40.5	40.5	40.7	40.7	40.5	40.6 *	40.0 †
Iron and steel and their products	40.2	40.0	40.4	40.4	40.3 *	40.4	
Nondurable goods industries	40.7	40.4	40.1	39.6	39.8 *	39.8 *	39.8 †
Textile-mill products and other fiber manufactures	40.5	40.4	40.0	39.1	38.9	38.6	
Nonmanufacturing industries (U.S. Dept. of Labor):							
Building construction	37.6	36.9	38.0	37.1	37.7	37.7 *	
Pay rolls:							
Production-workers pay rolls, unadjusted index, all manufacturing (U.S. Dept. of Labor) (1939 = 100)	307.3	310.6	314.1	310.7	312.2 *	319.4	
Durable goods industries	340.0	344.6	349.9	349.9	353.8 *	365.4	
Iron and steel and their products	287.9	287.9	294.2	297.5	306.7	315.0	
Nondurable goods industries	275.3	277.4	279.2	272.3	271.6	274.4	
Textile-mill products and other fiber manufactures	254.3	262.0	265.0	255.4	248.3	242.5	
Wages:							
Average weekly earnings, manufacturing industries (dollars):							
Natl. Ind. Conf. Bd. (25 industries)	51.62	52.10	52.10	52.79	53.65*	54.25	
U.S. Dept. of Labor, all manufacturing	47.10	47.29	47.69	47.50*	48.46	49.37*	49.25
Durable goods industries	49.60	49.74	50.30	50.34*	51.72*	52.95*	52.41
Iron and steel and their products	50.64	50.33	51.31	51.78*	53.70*	55.11	
Blast furnaces, steel works, and rolling mills	50.89	50.67	51.77	52.83	56.26	58.12	
Electrical machinery	48.63	48.13	49.07	48.36*	50.24	51.57	
Machinery, except electrical	53.12	53.22	53.82	54.25	55.22*	56.29	
Machinery and machine-shop products	52.78	52.61	53.10	53.31	54.44	55.37	
Machine tools	56.17	56.09	56.46	56.06	57.13	58.31	
Automobiles	54.13	54.29	55.45	54.14	55.96*	57.40	
Nondurable goods industries	44.47	44.67	44.89	44.40	44.93	45.47*	45.89
Textile-mill products and other fiber manufactures	39.29	40.32	41.01	40.12	39.89	39.54	
Cotton manufactures, except small wares	37.06	37.56	39.22	38.53	37.73	37.10	
Silk and rayon goods	40.21	41.45	41.94	40.89	41.73*	41.08	
Woolen and worsted manufactures (except dyeing and finishing)	43.10	47.44	46.28	45.26	45.28	45.75	
Apparel and other finished textile products	38.22	38.74	38.41	35.44	35.36	35.77	
Men's clothing	41.70	41.86	41.99	40.45*	41.18	40.97	
Women's clothing	47.30	48.77	47.75	42.32	41.33	41.87	
Leather and leather products	40.18	40.29	40.11	39.44	39.50	40.09	
Boots and shoes	39.05	38.96	38.91	37.96	37.86	38.41	
Food and kindred products	47.31	46.40	46.05	46.20*	47.71	48.87	

* Revised.

† Preliminary.

Source: *Survey of Current Business*, September, 1947, pp. S-1, S-3–S-13.

EXHIBIT 3

[The U.S. Bureau of Foreign and Domestic Commerce Industrial Reference Service (formerly called "Market Research Series" and currently "World Trade in Commodities") publishes information on domestic and foreign markets and supplies for a wide range of product groups. Most of the studies are made on a one-time basis. The text and tables that follow are reproduced from *Salad Dressing, Mayonnaise, and Related Products, 1945*.[1]]

TOTAL PRODUCTION

Production of salad dressing, mayonnaise, and related products in 1945 experienced the sharpest decline since the imposition of wartime controls checked the steady upward trend in output. Output in 1945 is estimated at 46.8 million gallons, almost 12 million less than the 1944 figure. The principal cause of the decline was the reimposition of rationing controls early in 1945, which severely curtailed the quantities of oil that mayonnaise and salad dressing manufacturers were permitted to use during most of the year. Manufacturers' invoice value of the 1945 output is estimated at nearly $78 million, compared with $95.3 million for the preceding year. The decline in dollar value amounted to 18.3 percent, not quite as much as the 20.3 percent drop in gallonage production. Increases in the manufacturers' average value of all major varieties helped to maintain the total dollar value of output.

The increase in output of salad dressings that may take place in 1946 will be small. Although rationing restrictions on the use of oils are no longer in effect, supplies of preferred oils are still short. To a lesser extent the existing restriction on the use of sugar is also a limiting factor. With the industry continuing to face problems in obtaining adequate supplies of raw materials, total production of salad dressing products in 1946 will not be materially higher than the 1945 output.

COVERAGE OF THE SURVEY

Estimates of the total output of salad dressing products during the years 1940 through 1943 were based on a sample of firms which represented 90 percent of total production as reported in the Census of Manufactures, 1939. Since no Census of Manufactures has been conducted since 1939, it was not possible to determine the coverage represented by the sample in the years 1940–1943, but it was assumed that the relationship existing in 1939 continued to prevail.

In 1944 the salad dressing survey was extended so that it included 110 firms estimated to represent practically the entire industry. It was found that the sample of firms used for the years 1940–1943 accounted for a somewhat lower percentage of total production than was considered to be the case, and estimates of total output for those years were revised. These revisions, and an explanation of the procedure which was used in making them, appear in *Salad Dressing, Mayonnaise, and Related Products, 1944*.

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[1] U.S. Bureau of Foreign and Domestic Commerce, Industrial Reference Service, Vol. 4, Part 5, No. 17 (Washington, D.C., U.S. Government Printing Office, November, 1946), pp. 1–7.

In 1945 reports were obtained from 114 firms, while allowance was made for the 9 firms that responded in 1944 but failed to reply in 1945. Thus, the estimate of total output for 1945 appearing in this report is based on a study of 123 firms. The 1944 estimate of total production has been further revised in the light of the additional firms included in the 1945 survey. However, no revisions in the estimates for the years 1940 through 1943 have been made at this time because of insufficient data on the operations of the firms not included in the sample during these years.

Wartime Controls on Raw Materials

During the war years, the mayonnaise and salad dressing industry was directly affected by government regulations controlling prices, raw materials, and the use of containers. However, the greatest limitation on output was the lessened availability of vegetable oils.

Wartime controls on the use of oils by the salad dressing industry began in September 1942. War Production Board Conservation Order M-71 limited the quantities of oil that could be used in the manufacture of shortening, edible oils, mayonnaise, and salad dressings to 90 percent, later reduced to 88 percent, of the 1940–41 average usage. This action reduced the quantities of oil available for the production of mayonnaise and salad dressings.

Table 1

Estimated Total Commercial Production of Salad Dressing, Mayonnaise, and Related Products, 1937–1945

(Millions of gallons)

Product	1937	1938	1939	1940	1941	1942	1943	1944*	1945
Salad dressing	21.8	22.3	24.0	24.3	26.1	25.6	27.1	31.5	25.9
Mayonnaise	11.0	11.4	12.2	13.4	16.5	18.5	16.6	20.3	15.3
Sandwich spreads	3.8	3.4	3.6	3.9	4.7	5.3	4.2	3.8	2.9
French dressing	1.2	1.1	1.5	1.7	2.3	2.7	2.5	2.5	2.2
Others	0.4	0.4	0.4	0.4	0.7	1.0	0.5	0.6	0.5
Total	38.2	38.6	41.7	43.7	50.3	53.1	50.9	58.7	46.8

* Revised.

When Ration Order 16 became effective on March 29, 1943, mayonnaise and salad dressing manufacturers were brought under the rationing provisions of the order as industrial users. Consumption of oil by the industry continued to be limited, with the base period changed to 1942. As a result of restrictions on oil usage, the 1943 output of mayonnaise, salad dressing, and related products declined more than 2 million gallons. This was the first time since 1935 that production was less than that of the preceding year. Adjustments made by the industry prevented a greater decline in 1943 total output. Oil was shifted to the production of salad dressing since the oil content in that product could be reduced to a certain degree. The production of specialty products—thousand island dressing, sandwich spreads, etc.—was cut in order to make more oils available for mayonnaise and salad dressing.

Rationing restrictions on the acquisition and use of vegetable oils were eased in 1944. During the first quarter of the year, mayonnaise and salad dressing manufacturers were permitted to acquire vegetable oils equal to 100 percent of 1942 usage. Beginning with April 16 and continuing for the balance of 1944, no ration points were required for the acquisition of vegetable oils nor were there any direct restrictions on the quantities that could be used by the salad dressing industry. As a consequence total production of salad dressing, mayonnaise, and related products in 1944 rose to 58.7 million gallons, almost 8 million more than the restricted output of 1943 and the highest production yet attained by the industry. Supplies of vegetable oils available to salad dressing manufacturers during this period generally could be acquired with less difficulty than the previous year. However, the quantities of oil available to salad dressing manufacturers were not unlimited since their suppliers, refiners of edible oils, were restricted in their output under provisions of War Food Order 42.

In 1945 the industry again faced serious problems of adequate supplies of its principal raw material. Rationing controls on vegetable oils were reestablished in January, and salad dressing manufacturers were once more directly limited in the quantity of oils they were allowed to use in the production process. Allotments to the industry decreased in successive quarters and by the third quarter of 1945 they reached the lowest levels of the war. In that quarter, the industry was permitted to use 60 percent of the oils consumed in 1942. In addition to the stringent limitations on usage, a shortage of vegetable oils prevented salad dressing producers from acquiring supplies of preferred oils. Reflecting these difficulties, total output of salad dressing, mayonnaise, and related products in 1945 suffered a sharp set-back, falling to the lowest level since 1940.

Although rationing controls ended in November 1945, two provisions of War Food Order 42 affect oil availability in 1946. The first and perhaps most important provision continues to limit production of oils for use in manufactured products such as shortening, salad oils, and other edible oils to a specified percentage of average 1940–41 output. The other provides for an equitable distribution pattern between tank cars and larger-size containers on the one hand and consumer-size containers on the other.

Limitations on the use of spices and sugar also had a restricting effect on production of salad dressing products during the war years, but not to the same extent as controls on use of oils. Use of many spices was limited, beginning in May 1942, although some, including paprika, continued in free supply. Improving supplies made possible increased quotas for clove and pimento in 1942 and 1943 and the termination of controls on these spices in the first quarter of 1944. Quota limitations on the use of mace, which fluctuated between 40 percent and 80 percent of 1941 utilization, were removed at the close of 1944. However, pepper remained short throughout all of the war period, compelling reductions in permitted usage. Although quotas were generally higher in 1942 and 1943, for most of 1944 use of pepper was controlled at 40 percent of 1941 consumption. Permitted use was reduced to 25 percent for most of 1945, with this quota currently continuing in effect.

Limitations on the use of sugar by the mayonnaise and salad dressing industry also date from May 1942. Permitted usage in 1942 and 1943 ranged from 70 percent to 90 percent of 1941 utilization and remained at 80 percent throughout all of 1944. In 1945 the salad dressing industry faced not only curtailed use of oils but more stringent restrictions on sugar consumption. In that year, allotment quotas were reduced, and ranged from 50 percent to 70 percent of base-period usage. Controls on the use of sugar continue in 1946, with the quotas set at 50 percent for the first quarter and 60 percent for the second and third quarters.

PRODUCTION BY VARIETIES

All varieties of salad dressing products experienced a drop in production in 1945. This was the first time since the United States entered the war that production of every variety was less than that of the preceding year. Output of salad dressing as reported by 99 identical firms declined 5.5 million gallons or 19 percent, while mayonnaise gallonage decreased 5 million or 26 percent. According to survey figures, production of the specialty items also registered declines, with the output of sandwich spreads and thousand island dressing showing the greatest proportionate decreases. Sandwich spreads decreased 25 percent in production volume, while the output of thousand island dressing was more than cut in half. French dressing showed a more moderate decline, falling 9 percent below the previous year.

As in 1943, when the industry was compelled to operate on reduced supplies of vegetable oils, producers in 1945 made adjustments in production to help maintain total output. The principal change was a curtailed output of mayonnaise in favor of salad dressing. The percentage of total output represented by mayonnaise declined from 35 percent to 33 percent, whereas the proportion represented by salad dressing increased from 53 percent to 55 percent. Apparently producers preferred to use a greater proportion of their available oil supply in the production of salad dressing where the oil content could be reduced to a certain degree. The relative position of French dressing increased over the previous year, but that of sandwich spreads and thousand island dressing dropped slightly.

The percentage decline occurring in production was greater than that in sale value for all major varieties. The dollar value of salad dressing and sandwich spread in particular was maintained despite curtailed output. Salad dressing declined 19 percent in production volume but only 15 percent in dollar value, while sandwich spread decreased 25 percent in output but only 20 percent in value. Increased manufacturers' average value of these products accounts for the maintenance of their total sales value.

PRODUCTION BY SALES SIZE CLASS

The production of 99 firms reporting in both 1944 and 1945 is shown in total (Table 2) and broken down by sales size class (Table 3). Ten firms in the group reported sales of $1 million or over in 1945, and accounted for about three-fourths of the total production reported by all 99 firms. The "million dollar sales" firms in the group were relatively more important in 1944, totaling 12 firms which accounted for nearly 80 percent of total output for all 99 firms.

TABLE 2

CHANGES IN PRODUCTION OF SALAD DRESSING AND RELATED PRODUCTS, 1944–45 *

Product	Thousands of Gallons		Percent Change	Thousands of Dollars		Percent Change
	1944	1945		1944	1945	
Salad dressing......	28,772	23,268	−19.1	42,647	36,122	−15.3
Mayonnaise.........	19,107	14,076	−26.3	35,473	26,503	−25.3
Sandwich spreads...	3,504	2,620	−25.2	5,587	4,452	−20.3
French dressing.....	2,377	2,160	−9.1	4,312	3,983	−7.6
Thousand island....	151	70	−53.6	330	133	−59.7
Others.............	293	381	......	359	490	
Total............	54,204	42,576	−21.5	88,709	71,684	−19.2

* The combined figures of 99 firms, each reporting for both years. Totals represent sum of unrounded numbers.

TABLE 3

PRODUCTION OF SALAD DRESSING, MAYONNAISE, AND RELATED PRODUCTS BY SALES SIZE CLASS, 1944 AND 1945

Sales Size Class	Number of Firms		Total		Salad Dressing		Mayonnaise		Sandwich Spreads		French Dressing		Others	
	1944	1945	1944	1945	1944	1945	1944	1945	1944	1945	1944	1945	1944	1945
	Thousands of Gallons													
$1,000,000 and over.....	12	10	42,465	31,657	23,314	17,516	14,090	10,153	2,782	2,054	1,945	1,620	335	313
$500,000–$1,000,000.....	10	12	4,863	4,980	1,586	2,402	2,865	2,067	385	329	26	175	1	7
$100,000–$500,000.......	32	28	5,583	4,589	3,220	2,469	1,730	1,582	298	191	308	288	26	58
$50,000–$100,000........	17	20	934	1,039	458	712	317	170	34	45	46	40	79	71
Less than $50,000.......	28	29	360	311	194	170	105	104	5	*	52	36	4	2
Total...............	99	99	54,204	42,576	28,772	23,268	19,107	14,076	3,504	2,620	2,377	2,160	445	451
	Thousands of Dollars													
$1,000,000 and over.....	12	10	71,739	55,378	36.254	28,824	26,686	19,458	4,633	3.632	3,629	3,081	537	382
$500,000–$1,000,000.....	10	12	7,466	7,704	1,978	3,155	4,923	3,811	518	453	46	271	1	15
$100,000–$500,000.......	32	28	7,649	6,657	3.599	3,001	3,161	2,738	381	292	442	457	65	169
$50,000–$100,000........	17	20	1,288	1,451	567	919	509	301	47	75	88	103	77	52
Less than $50,000.......	28	29	567	494	250	222	193	195	8	*	107	71	9	5
Total...............	99	99	88,709	71,684	42,647	36,122	35,473	26,503	5.587	4.452	4,312	3,983	690	623

* 375 gallons with a value of $762.

Note: Totals, sum of unrounded numbers. Data represent combined figures of 99 firms reporting for both years.

MANUFACTURERS' AVERAGE VALUES

The average invoice value of all types of salad dressing products except thousand island dressing increased in 1945. Increases were greatest for sandwich spreads and salad dressing, which rose 12 percent and somewhat more than 3 percent respectively. The over-all increase of 2 percent was the smallest since our entry into the war, and compares with 4 percent in 1944 and 7 percent in 1943.

As in 1944, important factors causing the increase in average values were the shift away from less profitable larger-size containers (Table 7) and from less profitable packs under private label for chain store outlets (Table 8).

TABLE 4

MANUFACTURERS' AVERAGE VALUE, BY TYPE OF PRODUCT, 1939–1945

Product	Dollars per Gallon							Percent Change 1944–1945
	1939	1940	1941	1942	1943	1944 *	1945	
Salad dressing......	1.00	1.03	1.12	1.35	1.49	1.47	1.52	+3.4
Mayonnaise........	1.41	1.39	1.42	1.68	1.76	1.85	1.86	+0.5
Sandwich spreads...	1.26	1.30	1.35	1.51	1.61	1.60	1.79	+11.9
French dressing.....	1.40	1.48	1.53	1.77	1.83	1.81	1.83	+1.1
Thousand island....	1.52	1.63	1.63	1.99	2.12	2.08	1.90	−8.7

* Revised.
Note: Based upon reports from 110 firms in 1944 and 114 firms in 1945.

TABLE 5

CHANGES IN THE AVERAGE VALUE PER GALLON OF SALAD DRESSING, MAYONNAISE, AND TOTAL SALAD DRESSING PRODUCTS, 1944 AND 1945, BY SALES SIZE CLASS

(Dollars)

Sales Size Class *	Number of Firms	All Products		Salad Dressing		Mayonnaise	
		1944	1945	1944	1945	1944	1945
$1,000,000 and over....	10	1.70	1.75	1.57	1.65	1.91	1.92
$500,000–$1,000,000....	12	1.51	1.55	1.22	1.31	1.74	1.84
$100,000–$500,000......	28	1.36	1.45	1.09	1.22	1.74	1.73
$50,000–$100,000.......	20	1.33	1.40	1.21	1.29	1.78	1.78
Less than $50,000......	29	1.55	1.59	1.31	1.32	1.74	1.87
Total...............	99	1.64	1.68	1.48	1.55	1.86	1.88

* Based on sales in 1945.

TABLE 6

AVERAGE ANNUAL WHOLESALE PRICES OF PRINCIPAL RAW MATERIALS USED IN THE MANUFACTURE OF SALAD DRESSINGS—1939–1945

Commodity	Dollars							Percent Change from 1944 to 1945
	1939	1940	1941	1942	1943	1944	1945	
Eggs, fresh, U.S. standard, per dozen	0.175	0.188	0.254	0.331	0.392	0.353	0.372	+5.4
Cottonseed oil, per pound..........	0.066	0.062	0.105	0.139	0.140	0.143*	0.143	
Corn oil, refined, per pound.........	0.088	0.083	0.130	0.161	0.162	0.164	0.166	+1.2
Vinegar, cider, per gallon...........	0.097	0.109	0.106	0.133	0.154	0.225	0.231	+2.7
Starch, corn, per pound............	0.044	0.014	0.041	0.043	0.051†	0.058	0.058	
Olive oil, per gallon................	1.831	2.375	4.657	4.832	5.065	‡	‡	
Sugar, granulated, per pound.......	0.046	0.044	0.049	0.055	0.055	0.055	0.054	−1.8
Salt, American, medium per 280 lb. barrel...........................	2.750	2.750	2.835	2.974	2.968§			
Salt, American, common granulated, 100 lb. sack.....................	.....	.....	.....	.....	0.893	0.890	0.890	

* Average for 10 months.
† Average (6 months 0.043; 6 months 0.058).
‡ No quotation.
§ Average for first 8 months of 1943.
Note: Quotations at New York, except for eggs and salt, which are at Chicago.
Source: Bureau of Labor Statistics, U.S. Department of Labor, and trade publications.

TABLE 7

PACK OF SALAD DRESSINGS BY SIZE OF CONTAINERS—1944 AND 1945 *

Container	Number of Containers (in thousands)		Percent of Total Containers		Gallons Packed (in thousands)		Percent of Quantity Packed	
	1944	1945	1944	1945	1944	1945	1944	1945
4 fluid ounces...	2,326	359	0.5	0.1	73	11	0.1	†
Half pint.......	203,032	244,895	43.4	56.4	12,689	15,306	23.6	33.2
Pint............	226,930	161,418	48.5	37.1	28,366	20,177	52.6	43.8
Quart..........	22,709	14,294	4.9	3.3	5,677	3,573	10.6	7.7
Gallons.........	5,628	5,438	1.2	1.3	5,628	5,438	10.4	11.8
Others..........	7,090	7,870	1.5	1.8	1,477	1,601	2.7	3.5
Total	467,715	434,274	100.0	100.0	53,910	46,106	100.0	100.0

* As reported by 100 firms in 1945; 102 firms in 1944.
† Less than 0.5.

TABLE 8

SALES OF SALAD DRESSING BY METHOD OF DISTRIBUTION—1939–1945 *

(Percent of total)

Channels of Distribution	1939	1940	1941	1942	1943	1944	1945
Direct to retailer through own wagons or wagon distributors:							
Total	64.5	64.5	63.2	60.6	66.3	62.5	59.7
Independent retailers	47.9	48.0	47.8	45.3	50.2	48.6	45.8
Chain stores	16.6	16.5	15.4	15.3	16.1	13.9	13.9
Direct to retailer in other ways:							
Total	23.2	23.1	24.2	23.4	15.9	11.8	11.3
Independent retailers	1.4	1.1	2.1	1.4	0.9	2.5	3.0
Chain stores	21.8	22.0	22.1	22.0	15.0	9.3	8.3
Through wholesale grocers	11.8	11.8	11.9	12.6	11.1	16.2	20.7
To Government	†	†	†	2.2	5.5	6.1	6.3
Other ways	0.5	0.6	0.7	1.2	1.2	3.4	2.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

* As reported by 69 firms in 1943; 100 firms in 1944; 105 firms in 1945.
† Not reported prior to 1942.

TABLE 9

MONTHLY DISTRIBUTION OF SALAD DRESSING SALES, 1939–1945

(Percent of total)

Month	1939	1940	1941	1942	1943	1944	1945
March	9.6	8.5	7.8	8.6	9.3	7.9	9.4
April	10.4	10.3	10.0	9.7	8.3	8.1	9.4
May	10.4	9.7	10.4	9.2	8.6	9.8	10.0
June	11.0	9.9	10.3	11.0	10.4	10.3	8.7
July	11.0	11.4	11.0	10.7	9.1	8.7	7.6
August	8.2	9.3	8.1	8.8	8.9	10.1	7.9
Total, 6 spring and summer months	60.6	59.1	57.6	58.0	54.6	54.9	53.0
September	8.5	6.5	7.4	8.2	8.6	8.2	6.9
October	5.9	6.9	8.7	7.3	7.7	8.0	8.2
November	5.4	6.6	5.6	6.4	7.2	7.9	7.3
December	5.5	6.4	6.7	6.1	6.9	6.6	6.5
January	6.9	6.9	7.1	7.0	7.4	7.0	9.8
February	7.2	7.6	6.9	7.0	7.6	7.4	8.3
Total, 6 fall and winter months	39.4	40.9	42.4	42.0	45.4	45.1	47.0

Prices of Principal Raw Materials

Prices of the principal raw materials used in salad dressing manufacture generally remained stable in 1945, reflecting the existence of OPA ceilings. The prices of the vegetable oils, sugar, and salt in the main were unchanged, while small increases occurred in the price of eggs and vinegar.

Cottonseed oil, prime summer yellow, continued to be quoted at 14.3 cents per pound delivered in tank cars at New York. Corn oil was quoted at 16.6 cents per pound in drums, LCL, at New York, practically unchanged from the previous year. The OPA ceiling price of winterized cottonseed oil remained at 15.1 cents a pound, delivered in tank cars at New York, while the ceiling price for winterized soybean oil, same basis, continued at 13.9 cents per pound.

A firmer egg market in 1945 resulted in an average price of 37.2 cents a dozen, almost 2 cents higher than in 1944. In that year the Government was compelled to purchase eggs as a price support measure. Egg prices in 1945 on an average were approximately at ceiling levels.

The wholesale price of vinegar rose a little over a half-cent a gallon, selling at an average price of 23.1 cents a gallon in 1945. Since July 1943, when dollars-and-cents ceilings were first established on vinegar, two increases were granted by OPA to compensate vinegar manufacturers for higher costs.

Pack by Size of Container

Curtailed output of salad dressings in 1945 because of inadequate supplies of vegetable oils accentuated a wartime trend toward smaller-size containers. To achieve a wider distribution of their limited output, salad dressing manufacturers made greater use of half-pint containers and reduced their use of pint and quart containers. An additional incentive was the fact that smaller-size containers were more profitable than the larger ones.

The increased use of half-pint containers was made possible by the lifting of all WPB restrictions on the use of jars in the middle of 1944, except the requirement that no jars under 8 ounces be used. Previously, at least 60 percent of containers used to pack salad dressing products was restricted to pints or larger. The relaxation of this limitation permitted half-pint jars to be used freely in 1945, with the result that this size accounted for 56 percent of total containers used, compared with 43 percent in 1944. Half-pint containers accounted for 33 percent of the total quantity of salad dressings packed, compared with 24 percent in 1944 and 17 percent in 1942.

Use of the pint container declined in 1945, accounting for 37 percent of all containers used compared with 48.5 percent in the preceding year, and 44 percent of the total volume packed compared with 53 percent. However, pint containers still continued to be the most important size container used from the standpoint of volume packed, retaining that position since 1943. The quart container, which prior to 1943 had accounted for about 40 percent of the total quantity packed, represented less than 11 percent in 1944 and about 8 percent in 1945. The relative position of the gallon size container increased somewhat, reflecting purchases by the Government and institutional users.

In 1945 no new actions were taken with respect to use of containers by the salad dressing industry. The only restrictions currently in effect are (1) the prohibition of the use of containers under 8 ounces, and (2) the prohibition of the use of tinplate closures for all dressings except French.

CHANNELS OF DISTRIBUTION

Sales of salad dressing products direct to retailers through manufacturers' wagons or wagon distributors continued as the predominant method of distribution in 1945, accounting for nearly 60 percent of reported sales. In 1944 this channel of distribution accounted for 62.5 percent of total sales. A slight relative decrease occurred in direct sales to retailers in other ways, bringing total sales direct to retailers to 71 percent compared with 74 percent in 1944.

A change in the 1945 distribution pattern was the increased importance of movement through wholesale grocers. Sales through this channel accounted for nearly 21 percent of the reported total, whereas this method of distribution accounted for 16 percent in 1944. The percentage decline in 1945 production occurring among firms with sales under one-half million dollars was considerably less than that of larger firms. Since the smaller firms tend to distribute their output through wholesalers, this would explain in part the increased importance of this channel of distribution in 1945.

The relative position of chain stores declined slightly, reported manufacturers' sales to this outlet representing 22 percent of the 1945 total compared with 23 percent in 1944. More than any other channel, chain stores felt the impact of changes in distribution methods made by the salad dressing industry under the stress of wartime conditions. Chain stores accounted for 37 percent of reported sales as recently as 1942, contrasted with 22 percent in 1945.

Sales of salad dressings to the Government in 1945 continued to form somewhat over 6 percent of total reported sales. Procurement of salad dressings by the military will decline in 1946. As a result sales to the Government in 1946 will be considerably below the sales of $4.8 million reported for 1945. On the basis of average values, the quantity of salad dressing products delivered to the Government in 1945 is estimated at 2.6 million gallons.

SEASONAL SALES OF SALAD DRESSINGS

The apparent trend toward a more equal distribution of sales between the spring-summer and fall-winter seasons was resumed in 1945. In the 5-year period 1939–43, sales during the spring-summer months declined from 61 percent of the total to 55 percent. In 1944, sales during these seasons continued to represent 55 percent of the total, but dropped to 53 percent in 1945. The apparent equalization in sales in 1945 was caused by difficulties in securing raw materials during the spring and summer seasons. At that time severe restrictions on permitted usage of oils were in effect, while shortages of preferred types of oils in many cases prevented producers from acquiring their full allotments. As a result, sales during June, July, and August formed a considerably lower proportion of the annual total than has been the case in previous years.

EXHIBIT 4

[*The Milwaukee Journal* has made local market studies since 1922. The following pages are reproduced from the twenty-third annual report, *Consumer Analysis of the Greater Milwaukee Market, 1946.*[1] Similar survey methods are now being used by newspapers of nine other cities.]

FAMILY GROCERY BUYING HABITS

The following pages of the 1946 Consumer Analysis show latest trends in comparison to previous years in important family grocery buying habits.

PLACE OF PURCHASE OF MEATS, FRUITS, VEGETABLES

Both number and percentage of families who buy meat at the same store as other groceries have been increasing regularly over the past three years until the number in 1946 is 135,067 and the percentage 59 per cent.

DIVISION OF ALL GREATER MILWAUKEE FAMILIES ACCORDING TO PLACE WHERE THEY BUY MOST OF THEIR GROCERIES

Place	Per Cent 1946	Per Cent 1945	Families 1946	Families 1945
Neighborhood (independent)	48.96%	49.50%	112,175	112,675
A&P stores (super) *	28.54	29.67	65,244	67,537
A&P stores (regular)	1.73	1.97	3,960	4,484
Total A&P stores	30.27%	31.64%	69,204	72,021
National Tea (regular)	1.66	2.01	3,800	4,575
National Tea (self-service)	3.71	3.12	8,493	7,102
Total National Tea stores	5.37%	5.13%	12,293	11,677
I.G.A. stores	9.99	9.11	22,870	20,737
A.G. stores (Associated)	1.94	2.00	4,441	4,553
Steinmeyer's	1.59	1.88	3,640	4,279
Independent packing house markets †	1.27	.....	2,907	
Department stores	0.21	0.24	481	546
Miscellaneous	0.40	0.50	916	1,138

* Includes A&P self-service stores.

† For the first time in 1946, Independent packing house markets were listed separately in the Consumer Analysis questionnaire. Therefore, for the first time, separate preference figures are available for this organization. In all previous years, independent packing house figures were included under "Neighborhood Stores (Independent)."

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[1] Pp. 1–5, 12, 17, 61–64, 124–125. Reprinted by permission.

Likewise the number and percentage of families who buy fresh fruits and vegetables at the same store as other groceries have been increasing. In 1946 the number is 180,852 families and the percentage 79 per cent.

These figures broken down into income groups of families are shown in two separate charts on this page.

FRESH FRUITS AND VEGETABLES BOUGHT AT SAME STORE AS OTHER GROCERIES

	Per Cent			Number		
	1946	1945	1944	1946	1945	1944
$50 rent and up....	77.7%	75.7%	73.4%	55,853	50,349	40,922
$40–$50 rent.......	79.3	80.5	78.5	47,352	47,825	46,495
$30–$40 rent.......	79.8	79.5	76.7	50,023	51,788	52,191
Under $30 rent.....	80.0	79.0	77.6	27,624	28,952	33,332
Totals...........	79.0%	78.6%	76.5%	180,852	178,914	172,940

MEATS BOUGHT AT SAME STORE AS OTHER GROCERIES

	Per Cent			Number		
	1946	1945	1944	1946	1945	1944
$50 rent and up....	58.7%	56.1%	51.8%	42,195	37,238	28,934
$40–$50 rent.......	63.8	54.8	52.0	38,127	32,557	30,810
$30–$40 rent.......	55.7	52.1	51.2	34,938	33,868	34,850
Under $30 rent.....	57.3	51.3	50.8	19,807	18,800	21,830
Totals...........	59.0%	53.8%	51.5%	135,067	122,463	116,424

GROCERY SHOPPING DAYS

The following chart shows the days of the week that most groceries are bought. It reveals a downward trend since 1944 in both number and percentage of families who buy most of their groceries Monday through Thursday, until in 1946, 24,892 families or 10.9 per cent are buying groceries early in the week.

Both number and percentage of families who buy most of their groceries on Friday are shown as increasing since 1943, until in 1946, 116,853 families or 51.1 per cent are Friday buyers.

Saturday grocery buying is being done by a larger number and percentage of families in 1946 when 83,431 families, or 36.4 per cent, are shown to be Saturday buyers, than in 1945 when 81,965 families, or 36 per cent, were shown. Days of the week most groceries are purchased by income groups is shown in the chart on page 141.

DAY OF THE WEEK THAT MOST GROCERIES ARE BOUGHT—FOUR-YEAR TREND

	Per Cent of Families				Number of Families			
	1946	1945	1944	1943	1946	1945	1944	1943
Monday through Thursday	10.9%	11.1%	13.7%	10.2%	24,892	25,388	31,075	22,055
Friday	51.1	49.5	39.6	27.1	116,853	112,407	89,477	59,182
Saturday	36.4	36.0	43.3	58.1	83,431	81,965	97,802	126,888

PLACE OF GROCERY PURCHASES

The chart on page 138 shows the over-all figures on the place of grocery purchases for 1946 compared with 1945. It reveals that a smaller number and percentage of families in 1946 are buying most of their groceries at neighborhood independent stores. This number is 112,175 families, or 48.96 per cent, compared to 112,675 families, or 49.5 per cent, in 1945. Likewise, patronage of both A&P super and regular stores has declined. National Tea is shown with a decrease in patronage of their regular type stores and an increase in that of their self-service outlets, but National Tea has gained in all types of outlets patronized by 12,293 families, or 5.37 per cent, in 1946.

I.G.A. stores have increased in both number and percentage of family patrons to 22,870 families, or 9.99 per cent, in 1946.

TRENDS

The question "Where do you buy MOST of your groceries?" has been included in the Consumer Analysis since 1934. . . .

During 1935, 1936 and 1937 . . . independent neighborhood store preference held steady but dropped during the years 1938 and 1939 in comparison with gains by A&P stores which instituted super markets in 1938. Neighborhood independents declined steadily until 1942 as the A&P Super Markets increased. At the same time the regular A&P store preference declined and has since been growing smaller. In 1943 the independents took a surge upward and the A&P stores of both types are shown as declining since that year.

By 1945 the independent neighborhood grocers were patronized by 49.5 per cent of the families and all the A&P stores by 31.6 per cent. In 1946 the neighborhood independent stores are shown to have declined slightly in patronage to 48.9 per cent, and the A&P stores show a further decline to 30.2 per cent.

I.G.A. stores in recent years have been showing consistent gains in the patronage of families. In 1942 I.G.A. stores were shown as patronized by 5 per

Day of the Week That Most Groceries Are Bought—by Income Groups

	Monday through Thursday				Friday				Saturday			
	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number
	1946		1945		1946		1945		1946		1945	
$50 rent and up	11.3%	8,123	11.4%	7,577	56.3%	40,470	53.0%	35,228	30.6%	21,996	32.2%	21,402
$40–$50 rent	10.9	6,513	10.7	6,357	52.6	31,429	52.5	31,190	34.4	20,554	33.2	19,724
$30–$40 rent	10.3	6,461	10.5	6,836	48.3	30,297	47.9	31,183	40.1	25,153	38.3	24,934
Under $30 rent	11.0	3,795	12.6	4,618	42.4	14,657	40.4	14,806	45.5	15,728	43.4	15,905
Totals	10.9%	24,892	11.1%	25,388	51.1%	116,853	49.5%	112,407	36.4%	83,431	36.0%	81,965

WHERE MILWAUKEE BUYS GROCERIES

	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	Number of Stores 1946
Independent.....	56.1%	56.1%	56.1%	53.3%	53.3%	48.1%	44.1%	42.5%	48.6%	49.1%	49.5%	48.9%	1,491
A&P (regular)....	16.1	18.2	20.6	24.5	15.4	11.7	5.4	4.1	3.5	3.5	2.1	2.0	3
A&P (super).....	....	....	....	....	14.0	24.0	33.0	37.0	31.6	29.4	29.5	28.2	45
Total A&P.....	16.1%	18.2%	20.6%	24.5%	29.4%	35.7%	38.4%	41.1%	35.1%	32.9%	31.6%	30.2%	48
I.G.A...........	6.1	6.3	6.1	5.8	5.0	5.1	5.7	5.0	6.4	6.9	9.1	9.9	133
National Tea (regular).....	8.6	6.3	7.1	5.8	4.3	4.1	4.8	4.0	3.8	3.6	2.4	1.9	7
National Tea (self-service) .	....	....	....	....	....	....	....	2.4	2.4	3.0	2.7	3.4	35
Total National Tea.........	8.6%	6.3%	7.1%	5.8%	4.3%	4.1%	4.8%	6.4%	6.2%	6.6%	5.1%	5.3%	42

Editors' note: In this tabular presentation of the original color chart it was necessary to make rough estimates as to the breakdowns within both the A&P and the National Tea groups.

cent of the families. Prior to that year, the trend of I.G.A. store volume had been up and down. Since then, the I.G.A. preference has been increasing steadily with new gains in 1946 to 9.9 per cent of the total.

After instituting their self-service stores, National Tea in 1942 showed a gain over 1941. In 1943, a slight decrease was registered. In 1944, patronage of these stores increased, and then decreased slightly in 1945. In 1946, the National Tea patronage increased slightly to 5.3 per cent of the family shoppers.

BY INCOME GROUPS

Four charts are presented in these pages showing the place of purchase of most of their groceries by families according to the four income groups into which all Consumer Analysis figures are broken down.

These charts show that neighborhood independent stores gained slightly in patronage by the highest income group. In 1946, 44.13 per cent of the families in this group are patronizing the independent outlets compared to 42.98 per cent in 1945. The A&P Super Markets show a decrease in 1946 to 28.60 per cent of the families in this income bracket from 31.10 per cent in 1945, whereas their regular stores increased to 1.60 per cent in 1946 from 1.42 per cent in 1945. On the other hand, neighborhood stores lost slightly in patronage of families in the second highest income group, of which 49.28 per cent were patronizing neighborhood independent stores in 1946, compared to 50.13 per cent in 1945.

GROCERY STORE PREFERENCE BY INDIVIDUAL INCOME GROUPS

$50 and Up Rental Group

Place	Per Cent 1946	Per Cent 1945	Families 1946	Families 1945
Neighborhood (independent)	44.13%	42.98%	31,752	28,561
A&P stores (super) *	28.60	31.10	20,529	20,671
A&P stores (regular)	1.60	1.42	1,145	942
Total A&P stores	30.19%	32.52%	21,674	21,613
National Tea (regular)	2.00	2.69	1,446	1,783
National Tea (self-service)	5.46	4.55	3,921	3,026
Total National Tea stores	7.47%	7.24%	5,367	4,809
I.G.A. stores	12.61	12.22	9,066	8,131
A.G. stores (Associated)	1.64	1.91	1,173	1,269
Steinmeyer's	2.19	2.54	1,576	1,688
Independent packing house markets †	0.96	.....	690	
Department stores	0.27	0.24	191	158
Miscellaneous	0.54	0.35	394	238

* Includes A&P self-service stores.
† Covered separately for first time in 1946.

Grocery Store Preference by Individual Income Groups

$40 to $50 Rental Group

Place	Per Cent 1946	Per Cent 1945	Families 1946	Families 1945
Neighborhood (independent)	49.28%	50.13%	29,474	29,776
A&P stores (super) *	28.94	27.66	17,262	16,431
A&P stores (regular)	1.70	2.02	1,018	1,196
Total A&P stores	30.64%	29.68%	18,280	17,627
National Tea (regular)	1.09	2.09	655	1,238
National Tea (self-service)	3.61	3.84	2,155	2,282
Total National Tea stores	4.70%	5.93%	2,810	3,520
I.G.A. stores	9.53	10.00	5,696	5,950
A.G. stores (Associated)	2.52	2.24	1,500	1,331
Steinmeyer's	1.20	1.20	719	713
Independent packing house markets †	1.48	.....	882	
Department stores	0.16	0.22	94	130
Miscellaneous	0.49	0.60	295	363

* Includes A&P self-service stores.
† Covered separately for first time in 1946.

Grocery Store Preference by Individual Income Groups

$30 to $40 Rental Group

Place	Per Cent 1946	Per Cent 1945	Families 1946	Families 1945
Neighborhood (independent)	51.54%	53.81%	32,359	35,025
A&P stores (super) *	27.93	28.88	17,489	18,799
A&P stores (regular)	1.82	2.00	1,144	1,302
Total A&P stores	29.75%	30.88%	18,633	20,101
National Tea (regular)	1.98	1.35	1,243	874
National Tea (self-service)	2.71	2.14	1,698	1,395
Total National Tea stores	4.69%	3.49%	2,941	2,269
I.G.A. stores	8.65	6.83	5,426	4,455
A.G. stores (Associated)	1.93	2.00	1,211	1,301
Steinmeyer's	1.46	2.14	920	1,390
Independent packing house markets †	1.51	.....	941	
Department stores	0.16	0.25	99	161
Miscellaneous	0.31	0.60	196	399

* Includes A&P self-service stores.
† Covered separately for first time in 1946.

GROCERY STORE PREFERENCE BY INDIVIDUAL INCOME GROUPS

Under $30 Rental Group

Place	Per Cent 1946	Per Cent 1945	Families 1946	Families 1945
Neighborhood (independent)....	53.74%	52.72%	18,590	19,313
A&P stores (super) *..........	28.86	31.76	9,964	11,636
A&P stores (regular)...........	1.89	2.85	653	1,044
Total A&P stores............	30.75%	34.61%	10,617	12,680
National Tea (regular).........	1.32	1.87	456	680
National Tea (self-service)......	2.08	1.07	719	399
Total National Tea stores.....	3.40%	2.94%	1,175	1,079
I.G.A. stores..................	7.76	5.98	2,682	2,201
A.G. stores (Associated).......	1.61	1.78	557	652
Steinmeyer's..................	1.23	1.34	425	488
Independent packing house markets †.....................	1.14	.....	394	
Department stores.............	0.28	0.27	97	97
Miscellaneous.................	0.09	0.36	31	138

* Includes A&P self-service stores.
† Covered separately for first time in 1946.

SELF-SERVICE OR CLERK SERVICE

The preference of families when shopping for groceries at INDEPENDENT neighborhood stores for self-service or clerk service was first covered in the Consumer Analysis in 1945. Comparisons are therefore available with that year. The chart on page 146 shows the answers for each year tabulated by income groups. Taking the total for all groups, the chart shows declines in both number and percentage of families who prefer self-service from 156,379 families, or 68.7 per cent, in 1945 to 147,658 families, or 64.5 per cent, in 1946.

DIVISION OF ALL FAMILIES AS TO WHETHER THEIR GROCERS ARE NOW MAKING REGULAR DELIVERIES

	Per Cent	Number
$50 rent and up......	20.5%	14,776
$40–$50 rent.........	18.6	11,134
$30–$40 rent.........	19.4	12,199
Under $30 rent.......	20.2	6,990
Total.............	19.7%	45,099

Division of All Families as to Type of Service Preferred When Shopping at Independent Neighborhood Stores

	Self-Service				Clerk-Service				Miscellaneous			
	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number	Per Cent	Number
	1946		1945		1946		1945		1946		1945	
$50 rent and up......	70.5%	50,708	71.0%	47,141	28.6%	20,509	28.2%	18,751	0.9%	666	0.8%	575
$40–$50 rent.........	58.8	35,145	68.4	40,587	39.8	23,761	31.0	18,417	1.4	844	0.6	406
$30–$40 rent.........	63.4	39,778	67.6	43,958	36.0	22,571	32.2	20,963	0.6	377	0.2	180
Under $30 rent.......	63.7	22,027	67.5	24,693	35.8	12,368	32.1	11,750	0.5	173	0.4	205
Totals............	64.5%	147,658	68.7%	156,379	34.6%	79,209	30.7%	69,881	0.9%	2,060	0.6%	1,366

HOT BREAKFAST FOODS

"Do You Buy Package Breakfast Foods Which Must Be Cooked before Eating?"

"Yes"	Of All Families		"No"	Of All Families	
	Per Cent	Number		Per Cent	Number
1946	79.6%	182,226	1946	20.4%	46,701

HIGH SPOT SUMMARY

NEW QUESTION ASKED IN 1946

Prior to 1946, the Consumer Analysis covered breakfast foods according to "corn," "rice" and other types. This year the subject covers only two broad classifications, "hot" and "cold." Therefore, direct comparisons of the 1946 data with previous years are not made.

NUMBER OF USERS

In 1946, 182,226 families, or 79.6 per cent of all families, buy hot breakfast foods.

ASKED TO INDICATE CHOICE

In 1946, consumers were asked to indicate their first, second and third choice of breakfast foods. They indicated 44 brands as first choice, 57 as second choice and 45 as third choice.

STORE DISTRIBUTION

Dealer distribution of brands was checked in 1946 according to "hot" and "cold" classifications. Distribution data of other years may be found by referring to the Consumer Analysis editions for those years.

BUYERS BY INCOME GROUPS

	Per Cent	Number
$50 rent and up	82.1%	59,017
$40–$50 rent	78.2	46,725
$30–$40 rent	79.5	49,867
Under $30 rent	77.0	26,617

TOTAL NUMBER OF BRANDS IN USE

Year	Number
1946	
1st Choice	44
2nd Choice	57
3rd Choice	45

CONSUMER PREFERENCE AND DEALER DISTRIBUTION OF LEADING BRANDS IN GREATER MILWAUKEE

Brand	First Choice		Second Choice		Third Choice		Dealer Distribution by Brands	
	Per Cent	Number	Per Cent	Number	Per Cent	Number	Independ. Grocers	Chain Grocers§
	1946		1946		1946		1946	1946
Quaker Oats	71.2%	129,745	23.4%	42,641	13.4%	24,419	98.6%	(A) (N)
Cream of Wheat	9.7	19,498	30.1	55,041	23.9	43,552	94.6	(A) (N)
Pillsbury's Farina	4.9	8,929	14.4	26,241	9.0	16,400	76.3	(A) (N)
Ralston	3.6	6,560	9.9	18,040	19.6	35,716	59.0	(A) (N)
Coco-Wheats	1.4	2,551	3.1	5,649	5.4	9,840	27.3	(A) (N)
Malt-O-Meal	1.4	2,551	4.5	8,200	9.3	16,947	43.0	(A) (N)
Mother's Oats	1.4	2,551	....	......	....	......	10.3	
Sunnyfield Rolled Oats	1.1	2,004	....	......	....	......	....	(A)
Quaker Farina	....	....	4.2	7,653	3.4	6,196	....	(A)
Ann Page Farina	....	....	2.1	3,827	2.0	3,645	17.0	
Quaker Corn Meal	....	....	1.1	2,004	2.2	4,009	47.6	(A) (N)
Grape Nuts Wheat Meal	....	....	....	......	2.7	4,920	18.3	(A)
Wheatena	....	....	....	......	1.4	2,551	20.0	
Wheatsworth	....	....	....	......	1.1	2,004	16.6	(A) (N)
Miscellaneous	4.5*	8,200*	7.2†	13,120†	8.0‡	14,578‡		

* Includes all brands used by less than 1 per cent (36 brands).
† Includes all brands used by less than 1 per cent (48 brands).
‡ Includes all brands used by less than 1 per cent (33 brands).
§ Key to chain grocers—(A) A&P. (N) National Tea.

PREPARED CAKE FLOUR

"Do You Buy Prepared Cake Flour in Packages?"

"Yes"	Of All Families		"No"	Of All Families	
	Per Cent	Number		Per Cent	Number
1946	68.7%	157,273	1946	31.3%	71,654
1945	63.4	144,315	1945	36.6	83,311
1944	59.3	134,057	1944	40.7	92,009
1943	57.1	124,685	1943	42.9	93,678

HIGH SPOT SUMMARY

MORE FAMILIES BUY IT

The Consumer Analysis has shown consistent annual increases in both number and percentage of families buying prepared cake flour until 157,273 families, or 68.7 per cent, buy it in 1946.

BUYERS ACCORDING TO INCOMES

As incomes grow larger, the percentages of families in the various income groups using prepared cake flour grow larger. The percentages run from 60.3 per cent in the lowest income group to 73.2 per cent in the highest.

MORE BRANDS USED

In 1946, 23 brands are in the market, compared to 21 brands in 1945.

SWANSDOWN IS THE LEADER

In 1946, 92,162 families, or 58.3 per cent of all families buying prepared cake flour, buy Swansdown. This is a larger number than the 85,579 families, but a smaller percentage than the 59.3 per cent using Swansdown in 1945.

Softasilk, second brand in popularity, is bought by 33,499 families, or 21.3 per cent, in 1946, compared to 26,698 families, or 18.5 per cent, in 1945.

NOT MUCH CHANGE IN DISTRIBUTION

Only slight changes in 1946, compared to 1945, are shown for the percentage of independent store distribution of all leading brands. No change was found in the chain store situation.

BUYERS BY INCOME GROUPS

	Per Cent	Number
$50 rent and up	73.2%	52,618
$40–$50 rent	69.3	41,407
$30–$40 rent	67.6	42,403
Under $30 rent	60.3	20,845

TOTAL NUMBER OF BRANDS IN USE

Year	Number
1946	23
1945	21
1944	22
1943	25

CONSUMER PREFERENCE AND DEALER DISTRIBUTION OF LEADING BRANDS IN GREATER MILWAUKEE

Brand	Per Cent of All Families Buying Prepared Cake Flour Who Use Each Brand				Total Number of Greater Milwaukee Families Using Each Brand				Dealer Distribution by Brands			
									Independent Grocers		Chain Grocers †	
	1946	1945	1944	1943	1946	1945	1944	1943	1946	1945	1946	1945
Swansdown	58.6%	59.3%	57.6%	60.2%	92,162	85,579	77,217	75,060	82.1%	85.3%	(A) (N)	(A) (N)
Softasilk	21.3	18.5	22.1	16.8	33,499	26,698	29,627	20,947	69.0	69.3	(A) (N)	(A) (N)
Sno-Sheen	14.4	13.6	12.1	11.6	22,647	19,627	16,221	14,463	69.2	66.3	(A) (N)	(A) (N)
Sunnyfield	4.1	5.6	5.3	7.6	6,448	8,082	7,105	9,476	....	....	(A)	(A)
Miscellaneous *	3.6	3.5	4.4	5.9	5,662	5,051	5,899	7,356				

* Including all brands used by less than 1 per cent of the total consumers of prepared cake flour (1946—19 brands; 1945—17 brands).

† Key to chain grocers—(A) A&P. (N) National Tea.

SOAP PRODUCTS FOR HOUSEHOLD LAUNDRY

"What Package Soap Product Do You Use for Household Laundry?"

"Users"	Of All Families		"Non-Users"	Of All Families	
	Per Cent	Number		Per Cent	Number
1946	99.2%	227,096	1946	0.8%	1,831
1945	99.5	226,488	1945	0.5	1,138
1944	99.7	225,388	1944	0.3	678
1943	98.3	214,651	1943	1.7	3,712

HIGH SPOT SUMMARY

LARGER NUMBER, SMALLER PERCENTAGE OF BUYERS

In 1946, 227,096 families, or 99.2 per cent of all families, use soap products for general household laundry, compared to 226,488 families, or 99.5 per cent, in 1945.

LARGER NUMBER OF BRANDS

In 1946, families are using 95 brands, compared to 69 in 1945.

OXYDOL TAKES THE LEAD

From second place in 1945, Oxydol takes first place in popularity in 1946, with increases in both number and percentage of users. In 1946, Oxydol is used by 40,650 families, or 17.9 per cent of those using soap products for household laundry, compared to 37,823 families, or 16.7 per cent, in 1945.

DEALER DISTRIBUTION

The 1946 distribution check did not include brands of bar laundry soap. However, Ivory bar distribution is shown because it is also classed among toilet soaps, which were checked.

BUYERS BY INCOME GROUPS

	Per Cent	Number
$50 rent and up	99.2%	71,335
$40–$50 rent	98.9	59,093
$30–$40 rent	99.4	62,377
Under $30 rent	99.2	34,291

TOTAL NUMBER OF BRANDS IN USE

Year	Number
1946	95
1945	69
1944	89
1943	121

CONSUMER PREFERENCE AND DEALER DISTRIBUTION OF LEADING BRANDS IN GREATER MILWAUKEE

Brand	Per Cent of All Families Buying Soap for Household Laundry Who Use Each Brand				Total Number of Greater Milwaukee Families Using Each Brand				Dealer Distribution by Brands			
									Independent Grocers		Chain Grocers ‡	
	1946	1945	1944	1943	1946	1945	1944	1943	1946	1945	1946	1945
Oxydol	17.9%	16.7%	18.5%	17.5%	40,650	37,823	41,697	37,564	52.1%	88.3%	(A) (N)	(A) (N)
Fels-Naptha bar	17.1	18.4	21.6	20.2	38,883	41,674	48,684	43,360				
Rinso	15.4	13.2	15.5	14.3	34,973	29,896	34,935	30,695	42.1	87.0	(A) (N)	(A) (N)
Duz	13.7	13.6	11.6	8.7	31,112	30,802	26,145	18,675	59.1	87.3	(A) (N)	(A) (N)
John Hanser's	12.5	10.6	11.0	9.4	28,387	24,008	24,793	20,177	47.1	65.7	(A)	
P. & G. bar	3.6	8.4	10.6	16.5	8,175	19,025	23,891	35,417				
Super Suds	3.5	2.9	2.8	2.4	7,948	6,568	6,311	5,152	53.1	76.3	(A) (N)	(A) (N)
Ivory bar	3.0	3.3	2.1	3.8	6,813	7,474	4,733	8,157	63.1	94.0	(A) (N)	(A) (N)
Ivory flakes	1.6	1.3	1.1	2.2	3,634	2,944	2,479	4,722	36.0	42.0	.. ..	.. (N)
American Family bar	1.5	1.4	2.0	1.7	3,406	3,171	4,508	3,649				
Perk *	1.5	....	....	....	3,406	......	......	......	63.1	....	(A) (N)	
Fels-Naptha flakes	1.1	1.1	2.0	1.1	2,498	2,491	4,508	2,361	....	4.7	.. ..	.. (N)
Purdy's *	1.0	....	....	....	2,271	......	......	......	3.0			
Rad *	1.0	....	....	....	2,271	......	......	......	3.0			
Swan	1.0	1.3	1.1	1.8	2,271	2,944	2,479	3,864	52.1	83.0	(A) (N)	(A) (N)
Miscellaneous †	10.1	11.7	10.1	16.6	22,937	26,500	22,764	35,633				

* Used by less than 1 per cent in previous years and therefore included under "Miscellaneous" in those years.

† Including all brands used by less than 1 per cent of the total consumers of soap for household laundry (1946—80 brands; 1945—69 brands).

‡ Key to chain grocers—(A) A&P. (N) National Tea.

SOAP PRODUCTS USED FOR DISHES

"What Package Soap Product Do You Use for Dishes?"

"Users"	Of All Families		"Non-Users"	Of All Families	
	Per Cent	Number		Per Cent	Number
1946	99.6%	228,111	1946	0.4%	816
1945	99.5	226,488	1945	0.5	1,138
1944	99.6	225,162	1944	0.4	904
1943	99.4	217,053	1943	0.6	1,310

HIGH SPOT SUMMARY

MORE USERS

The number of users in 1946 is 288,111 families, or 99.6 per cent of all families, compared to 226,488, or 99.5 per cent, in 1945.

LARGER NUMBER OF BRANDS

In 1946, there are 103 brands, compared to 100 in 1945.

IVORY BAR MOST POPULAR

Ivory bar is used in 1946 by 38,095 families, or 16.7 per cent of those using soap products for dishes, which is a smaller number and percentage than the 43,259 families, or 19.1 per cent, using Ivory bar in 1945.

STORE DISTRIBUTION GENERALLY LOWER

The percentage of distribution among independent grocery stores of most brands has dropped in 1946, compared to 1945. The exceptions are Dreft, Vel and Perk.

BUYERS BY INCOME GROUPS

	Per Cent	Number
$50 rent and up......	99.6%	71,589
$40–$50 rent.........	99.6	59,481
$30–$40 rent.........	99.7	62,508
Under $30 rent.......	99.9	34,533

TOTAL NUMBER OF BRANDS IN USE

Year	Number
1946	103
1945	100
1944	98
1943	106

CONSUMER PREFERENCE AND DEALER DISTRIBUTION OF LEADING BRANDS IN GREATER MILWAUKEE

Brand	Per Cent of All Families Buying Soap for Dishes Who Use Each Brand				Total Number of Greater Milwaukee Families Using Each Brand				Dealer Distribution by Brands			
									Independent Grocers		Chain Grocers ‡	
	1946	1945	1944	1943	1946	1945	1944	1943	1946	1945	1946	1945
Ivory bar	16.7%	19.1%	23.3%	22.4%	38,095	43,259	52,463	48,620	63.1%	94.0%	(A) (N)	(A) (N)
Ivory flakes	13.2	12.3	10.3	8.7	30,111	27,858	23,192	18,884	39.1	42.0	.. ..	.. (N)
Duz	11.2	13.5	11.9	10.0	25,548	30,576	26,794	21,705	59.1	87.3	(A) (N)	(A) (N)
Chiffon flakes	7.7	2.6	....	....	17,565	5,889	......	......	51.1	69.3	.. (N)	(A) (N)
Rinso	7.7	8.2	9.6	8.5	17,565	18,572	21,616	18,450	42.1	87.0	(A) (N)	(A) (N)
Oxydol	6.3	8.9	8.2	8.0	14,371	20,157	18,463	17,364	52.1	88.3	(A) (N)	(A) (N)
Dreft *	5.5	....	....	....	12,546	......	......	......	63.1	....	(A) (N)	
Lux flakes	5.3	5.0	5.4	5.1	12,090	11,324	12,159	11,070	35.1	48.0	.. (N)	.. (N)
Swan	4.9	6.3	6.3	7.3	11,177	14,269	14,185	15,845	52.1	83.0	(A) (N)	(A) (N)
Vel	4.6	2.4	....	....	10,493	5,436	......	......	65.1	58.7	.. (N)	(A) (N)
Ivory Snow	4.1	4.6	4.0	3.4	9,353	10,418	9,006	7,380	28.0	38.3	.. ..	.. (N)
John Hanser's	3.6	4.6	5.0	5.0	8,212	10,418	11,258	10,853	44.0	65.7	(A)	
Super Suds	3.5	3.0	3.7	3.3	7,984	6,795	8,331	7,163	53.1	76.3	(A) (N)	(A) (N)
Perk *	1.7	....	....	....	3,878	......	......	......	63.1	....	(A) (N)	
Miscellaneous †	9.6	14.6	14.4	22.7	21,899	33,068	32,424	49,271				

* Used by less than 1 per cent in previous years and therefore included under "Miscellaneous" in those years.

† Including all brands used by less than 1 per cent of the total consumers of soap for dishes (1946—89 brands; 1945—86 brands).

‡ Key to chain grocers—(A) A&P. (N) National Tea.

CIGARETS (MEN)

"Do You Smoke Cigarets?"

"Yes"	Of All Men		"No"	Of All Men	
	Per Cent	Number		Per Cent	Number
1946	67.3%	154,068	1946	32.7%	74,859
1945	65.4	148,867	1945	34.6	78,759
1944	64.6	146,039	1944	35.4	80,027
1943	65.8	143,683	1943	34.2	74,680
1942	63.8	134,277	1942	36.2	76,189

HIGH SPOT SUMMARY

MORE MEN SMOKING

In 1946, 154,068 "husbands or men of the house," or 67.3 per cent of all of them, smoke cigarets, compared to 148,867, or 65.4 per cent, in 1945.

NEW QUESTION IN 1946

In 1946, men were asked whether they changed brands during the last year, and it was found that 31.5 per cent had done so.

SMALLER NUMBER OF BRANDS

In 1946, 21 brands are smoked by men, compared to 33 in 1945.

ALL "BIG FOUR" BRANDS GAIN

Lucky Strike leads in popularity, preferred in 1946 by 43,447 men, or 28.2 per cent of all men in this group smoking cigarets, which is a larger number and percentage than the 38,705, or 26 per cent, smoking Luckies in 1945.

DIVISION OF MEN SMOKING CIGARETS AS TO WHETHER THEY CHANGED BRANDS DURING THE LAST YEAR

	Per Cent	Number
Changed brands..........	31.5%	48,531
Did not change brands...	68.5	105,537

SMOKERS BY INCOME GROUPS

	Per Cent	Number
$50 rent and up	61.0%	43,849
$40–$50 rent	66.3	39,614
$30–$40 rent	70.6	44,285
Under $30 rent	76.2	26,320

TOTAL NUMBER OF BRANDS IN USE

Year	Number
1946	21
1945	33
1944	29
1943	37

MEN'S USE OF LEADING BRANDS OF CIGARETS IN GREATER MILWAUKEE

Brand	Per Cent of All Men Smoking Cigarets Who Use Each Brand				Total Number of Greater Milwaukee Men Smoking Each Brand			
	1946	1945	1944	1943	1946	1945	1944	1943
Lucky Strike	28.2%	26.0%	21.1%	23.3%	43,447	38,705	30,814	33,478
Camel	28.1	21.3	20.6	21.4	43,293	31,709	30,084	30,748
Chesterfield	20.0	15.4	14.5	13.3	30,814	22,926	21,176	19,110
Old Gold	12.5	12.0	11.6	9.9	19,259	17,864	16,941	14,225
Philip Morris	6.8	7.0	10.2	6.7	10,477	10,421	14,896	9,627
Pall Mall	4.6	4.2	4.3	4.5	7,087	6,252	6,280	6,466
Raleigh	2.1	4.7	9.3	10.9	3,235	6,997	13,582	15,661
Miscellaneous *	3.4	10.5	13.1	15.2	5,238	15,632	19,132	21,840

* Including all brands used by less than 1 per cent of the total men who smoke cigarets (1946—14 brands; 1945—21 brands).

CIGARETS (WOMEN)

"Do any Women in Your Family Smoke Cigarets?"

"Yes"	Of All Women		"No"	Of All Women	
	Per Cent	Number		Per Cent	Number
1946	34.2%	110,357	1946	65.8%	212,324
1945	32.0	103,178	1945	68.0	219,255
1944	29.2	93,515	1944	70.8	226,741
1943	27.2	85,519	1943	72.8	229,238
1942	27.5	73,224	1942	72.5	193,044

HIGH SPOT SUMMARY

MORE WOMEN SMOKING

Both number and percentage of women smoking cigarets have increased—to 110,357, or 34.2 per cent of all Greater Milwaukee women 18 years and over, in 1946, compared to 103,178, or 32 per cent, in 1945.

BY INCOME GROUPS

The largest percentage of women in any one group who smoke cigarets, or 40 per cent, represents the lowest income group. Percentages in the remaining groups grow smaller as incomes increase, until only 32 per cent of the women in the highest income group are shown to be cigaret smokers.

NUMBER OF BRANDS

There are 24 in 1946, the same number as in 1945.

THREE OF "BIG FOUR" GAIN

Chesterfield, Lucky Strike and Camel have increased in both number and percentage of women smokers in 1946 over 1945. Old Golds are smoked by a slightly larger number of women but a smaller percentage.

BUYERS AND NON-BUYERS BY INCOME GROUPS

	Buyers Per Cent	Non-Buyers Per Cent
$50 rent and up......	32.0%	68.0%
$40-$50 rent.........	33.2	66.8
$30-$40 rent.........	34.3	65.7
Under $30 rent.......	40.0	60.0

TOTAL NUMBER OF BRANDS IN USE

Year	Number
1946	24
1945	24
1944	30
1943	32
1942	29

WOMEN'S USE OF LEADING BRANDS OF CIGARETS IN GREATER MILWAUKEE

Brand	Per Cent of All Women Buying Cigarets Who Use Each Brand				Total Number of Greater Milwaukee Women Using Each Brand			
	1946	1945	1944	1943	1946	1945	1944	1943
Chesterfield.......	26.0%	18.0%	17.8%	17.3%	28,693	18,572	16,646	14,795
Lucky Strike......	24.0	23.4	18.8	20.0	26,486	24,144	17,581	17,103
Camel............	14.6	12.7	12.4	11.2	16,112	13,104	11,596	9,578
Old Gold.........	13.5	13.9	11.1	11.2	14,898	14,342	10,380	9,578
Philip Morris.....	8.2	8.3	12.5	8.9	9,049	8,564	11,689	7,611
Pall Mall.........	7.8	5.8	6.2	5.9	8,608	5,984	5,798	5,046
Raleigh...........	3.8	6.4	10.0	14.2	4,194	6,603	9,352	12,144
Kool.............	2.4	2.4	3.1	3.5	2,649	2,476	2,899	2,993
Viceroy *.........	1.2	....	....	....	1,324			
Regent *..........	1.1	....	....	....	1,214			
Miscellaneous †....	2.5	11.1	11.5	12.6	2,759	11,453	10,754	10,775

* Used by less than 1 per cent in previous years and therefore included under "Miscellaneous" in those years.
† Including all brands used by less than 1 per cent of the Greater Milwaukee women who smoke cigarets (1946—14 brands; 1945—13 brands).

EXHIBIT 5

[The Research Department of The Curtis Publishing Company has made a variety of studies dealing with urban and rural markets. As a rule each study is an entity and bears no relation to the others, and the same topics are not repeated on a regular basis. The following text and tables are excerpts from *Looking Ahead in the Farm Building Market.*[1]]

LOOKING AHEAD IN THE FARM BUILDING MARKET

PURPOSE OF THE SURVEY

The survey had six major objectives. It was designed to:

1. Measure the nature and size of the farm market for the construction, improvement or repair of farm buildings
2. Indicate the timing of the farmer's building activities
3. Determine the degree of knowledge and acceptance of new products or developments in the building field among farm consumers
4. Ascertain the farmer's opinions of the building industry and its methods
5. Suggest the proper type of merchandising approach to the farm building market
6. Measure the nature and size of the farm market for household appliances and furnishings

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[1] Prepared for *Country Gentleman* by the Research Department, Curtis Publishing Company (Philadelphia, 1945), pp. 3–6, 56–64. Reprinted by permission.

Scope of the Survey

Before a questionnaire was prepared, considerable time was devoted to an analysis of the building industry. As a result of this study, specific problem areas were defined, outlined and grouped into four broad classifications:

1. Those related to the fundamental economic background and inherent characteristics of the industry
2. Those related to distribution and selling policies and methods of the industry
3. Those related to financing policies and methods of the industry
4. Those related to governmental activity and its impact on the industry

These problem areas were amplified and analyzed in detail. Based on these findings it was decided to limit the scope of the survey to the first three of the above groups. Those phases dealing with governmental activity were considered to be extraneous to the purpose of the survey and were omitted.

At an early stage it was recognized that a comprehensive farm building survey should embrace not only the subject of dwellings but service structures as well. Since the farmstead must be viewed as an integral operating unit in which the productive plant and dwellings represent separate but vital parts of the whole, any attempt to limit the study to one, without the other, would give an imperfect and incomplete market story.

The survey was national in scope covering all geographic sections and all types of farming areas. While the type and character of consumer coverage presented something of a problem, it was decided to restrict the study to white farm owners and operators because of their predominance as a market factor. Nonwhites, sharecroppers and, in so far as possible, the bottom third of the white farmers—those operating marginal or submarginal properties—were not included in the sample. Consequently, the results of the survey must not be regarded as representing the entire farm population but, rather, *a carefully selected cross-section of the important buying part of the farm market.*

Survey Procedure

This survey is based on complete interviews with 2,342 farm families located in 44 states and 320 counties. Interviewing was by personal call, and only heads of families were interviewed; 66.6% of the interviews were conducted jointly with male and female family heads. The interviewing was done by experienced, local rural representatives of National Analysts, Inc., a national research organization. These representatives were thoroughly familiar with farm people and farm conditions in their respective territories. Close supervision was maintained over field personnel, and validity of results was achieved through the use of detailed instructions, preliminary questionnaire audits, continuous spot-checking of returns and sample controls.

The questionnaire was thoroughly pretested and revised many times before actual survey interviewing began. No leading questions were asked, and extreme care was taken to insure that answers would be free from bias or influence.

The survey sample was controlled by four factors: (1) farm tenure, (2) farm income, (3) farm location, (4) types of farming.

The sample was weighted so that about four out of five interviews would be with farm owners. Actually, 1,809, or 77.2%, of the interviews were with farm owners and 533, or 22.8%, were with tenants. There was a good reason for thus weighting the sample. Since farm building represents an addition to permanent property investment, farm owners should be in the best position to speak about their building plans and intentions. Bear in mind that the study was designed to indicate *action* rather than needs. Because of its breadth, however, the survey would not have been complete nor truly representative unless a tenant sample was also taken. Wherever tenants were interviewed information was obtained concerning their knowledge of the owner's building plans and their own plans to purchase such products as appliances, furnishings, etc. In no instance were the owner and the tenant of the same farm interviewed, thus avoiding any duplication of the sample.

Gross cash farm income was used as the income control factor because it provides a consistent measurement of productive income from farm operations. A 10-way income break was employed with controls providing for about 30% of the interviews in the lower income brackets (under $1,500), 20% in the lower middle income brackets ($1,500 to $2,499), 30% in the upper middle income brackets ($2,500 to $4,999), and 20% in the higher income brackets ($5,000 and over). These income breaks were predicated on up-to-date estimates of gross cash farm income supplied by the U.S. Department of Agriculture, and were used because the distinct upward trend in the farmer's income status during recent years required some deviation from previous farm income patterns.

Geographic distribution of the sample conforms generally to a national pattern of farm location. Some limitations were imposed by difficulties in transportation and the availability of interviewing personnel. Regional quotas were weighted and adjusted for differences in farm tenure and, wherever necessary, to compensate for quota deficiencies in certain areas to meet total survey requirements; these geographic adjustments, however, did not distort the sampling technique or affect the final result.

Further diversification was achieved by a proportionate sampling of all types of agricultural activity. For this purpose, farms were classified into eight major groups according to their most important source of income, as follows: livestock, dairy, cash grain, general, field specialties, fruit and vegetable, cotton, and poultry. This procedure did not lend itself readily to rigid percentage controls, but the final pattern constitutes a characteristic national cross-section of farm types. Counties covered by the survey were carefully selected as being representative of the principal agricultural pursuits in the sections where they were located. Survey quotas were further weighted and adjusted to coincide with the relative importance of farm types in specific census regions. In laying out the sample, U.S. Department of Agriculture "type of farming" area maps were utilized as a guide and followed as closely as survey conditions would permit.

A SELECTIVE MARKET SAMPLE

The economic level of the average farm consumer in this survey was considerably higher than that of the agricultural population as a whole. A quick glance at some of the essential characteristics of the farms covered by the survey emphasizes this fact. The size of the average farm was 211 acres; 71% of the farms were electrified; 51% had running water; 18% had gas service (either central mains, bottled or LP); and gross cash farm income averaged about $3,100.

It is worth repeating that this survey was never intended to be a scientific cross-sampling of the entire farm population of the country. On the contrary, it was deliberately planned as a study of that part of the farm market which could reasonably be expected to have a definite knowledge of postwar farm building plans and which would, therefore, offer the best sales opportunity. Consequently, the survey is characterized by a high element of market selectivity; it is a picture of a quality market—the type of market that *Country Gentleman* serves through its editorial and advertising pages.

> [Parts 1–5 of the study present statistics on the farmer's plans for new houses, the farmer's plans for repair or modernization of present dwellings and other farm structures, the farmer's interest in new construction methods including prefabrication, and the farmer's opinion of the building industry. Part 7 discusses sales opportunities and problems. Part 6 is reproduced below in its entirety, except that the charts have been reduced to tabular form.]

WILL THE FARMER BUY HOUSEHOLD APPLIANCES, FURNISHINGS AND EQUIPMENT?

The building industry is only one of many that will share in the postwar plans of American farmers. Goods and services which increase the livability, comfort, convenience and beauty of a home also play an important part in the farm family's "designs for living." One of the main objectives of the survey, therefore, was to develop information about the plans and intentions of farmers for the purchase of home furnishings, household appliances and equipment for their homes. It is the purpose of this section to discuss some of the highlights of these findings. More detailed analyses of the material will be prepared as need or demand for them occurs.

FURNITURE AND OTHER HOME FURNISHINGS

Manufacturers, distributors and retailers of furniture and other home furnishings can look forward to a substantial postwar volume of business from the farm market (Chart 19). Of all farm families interviewed 49.9% expect to buy one or more items in these lines when they become available. An additional 23% might be induced to buy but are as yet undecided. 27.1% do not expect to make any purchases. 50.4% of the owners interviewed and 48.5% of the tenants are definite consumer prospects. These farm families will spend an average of $255 for home furnishings and furniture, and owners will spend, on the average, considerably more than tenants for this purpose.

CHART 19

DO FARMERS EXPECT TO BUY NEW FURNITURE OR OTHER HOME FURNISHINGS WHEN THEY ARE AVAILABLE?

	Yes	Don't Know	No	Average Cost
Owners	50.4%	21.8%	27.8%	$273
Tenants	48.5	27.0	24.5	195
Total interviews	49.9	23.0	27.1	255

The farm families who planned to buy furniture and other home furnishings also provided specific information about the nature of these anticipated purchases (Table 33). 43.1% will buy bedroom furniture, 39.7% living room furniture, 21.4% rugs, 20.1% dining room furniture, 12.8% chairs. Other items mentioned by fewer than 10% are table desks, curtains, kitchen furniture and cabinets, pianos, linoleum, couches, porch furniture, silver and dishes. Owners and tenants ranked these purchases in about the same order.

TABLE 33

FURNITURE AND HOME FURNISHINGS FARM FAMILIES EXPECT TO BUY

Item	% Who Mention *
Bedroom furniture	43.1%
Living room furniture	39.7
Rugs	21.4
Dining room furniture	20.1
Chairs	12.8
Table desk	5.1
Curtains (including Venetian blinds)	3.9
Kitchen furniture	3.4
Cabinets	2.7
Piano	2.6
Complete refurnishing job	2.5
Linoleum	2.3
Studio couch	1.1
Porch furniture	0.9
Silver	0.4
Dishes	0.1
Other and miscellaneous	4.5
None given	2.3

* Some mentioned more than one item.

HOUSEHOLD APPLIANCES AND EQUIPMENT

There are real postwar sales opportunities for household appliances at all levels of the farm market. Although nearly all of the farm families covered by the survey now own household appliances of some kind, 68% of these families are potential buyers of one or more new appliances and expect to spend an average of $271 per family for this purpose (Chart 20). 32% seem to have no immediate buying plans for appliances, but active selling and advertising might change this. Owners will spend, on the average, more than tenants, but the relative buying intent of the two groups is practically the same.

CHART 20

DO FARMERS EXPECT TO BUY HOUSEHOLD APPLIANCES?

	Yes	No	Average Cost
Owners	68.1%	31.9%	$283
Tenants	67.7	32.3	233
Total interviews	68.0	32.0	271

The farm market, then, is worthy of the attention of every manufacturer and distributor in the appliance field. As Chart 21 shows, this market will absorb a wide variety of appliance products. 28.2% plan to buy a new refrigerator, 22.8% a range or cook stove, 21.3% a washing machine, 17.8% a vacuum cleaner, 15.8% an iron, 15.8% a radio without phonograph attachment, 15% a food mixer, 13.4% a quick or home freezer, 13.4% a toaster, 4.6% an ironer (mangle), 3.7% a radio with phonograph attachment, and 1.9% a mechanical dishwasher. Other items mentioned by fewer than 1% include a percolator, waffle iron, hot plate and sewing machine. With the exception of 15.1% of the

CHART 21

WHAT HOUSEHOLD APPLIANCES DO FARMERS EXPECT TO BUY?

Item	% Who Mention *
Refrigerator	28.2%
Range or cook stove	22.8
Washing machine	21.3
Vacuum cleaner	17.8
Iron	15.8
Radio: without phonograph	15.8
Food mixer	15.0
Quick or home freezer	13.4
Toaster	13.4
Ironer (mangle)	4.6
Radio: with phonograph	3.7
Dishwasher	1.9

* Other appliances mentioned by less than 1% of those answering.

owners and 7.7% of the tenants who mention a home freezer, there are no significant differences in the buying intent of the two groups for other items.

The farm families interviewed show a decided preference for electric appliances (Table 34). In appraising the market implications of this fact it must be remembered that a very high proportion of the farms included in the survey have electric service and also that some of the appliances are predominantly the type which can only be operated by electricity. A few of the families have no preference or don't know what type they will buy.

TABLE 34

TYPES OF APPLIANCES FARM FAMILIES WILL BUY

Appliance	Electric	Gas	Other	Don't Know
Refrigerator	78.6%	10.7%	7.8%	2.9%
Range or cook stove	42.2	24.5	27.2	6.1
Washing machine	85.6	8.1	4.0	2.3
Vacuum cleaner	98.2	....	0.5	1.3
Iron	90.9	5.2	2.1	1.8
Radio: without phonograph	89.3	....	7.9	2.8
Food mixer	99.4	....	0.3	0.3
Quick or home freezer	93.9	3.0	....	3.1
Toaster	98.9	....	....	1.1
Ironer (mangle)	99.0	1.0		
Radio: with phonograph	98.7	....	1.3	
Dishwasher	97.4	....	....	2.6

Some people have been under the impression that the farmer buys cheap merchandise. But those who deal with him and understand his buying habits know this is not true. Farmers want good quality at fair prices and will not pay exorbitant prices for features and items which do not have a practical value. These buying habits are clearly indicated by the average amount

CHART 22

HOW MUCH DO FARMERS PLAN TO SPEND FOR HOUSEHOLD APPLIANCES?

Item	Amount *
Refrigerator	$201
Range or cook stove	157
Washing machine	115
Vacuum cleaner	69
Iron	8
Radio: without phonograph	69
Food mixer	26
Quick or home freezer	279
Toaster	7
Ironer (mangle)	112
Radio: with phonograph	142
Dishwasher	163

* Figures are averages.

farmers expect to pay for appliances they intend to purchase (Chart 22). These cost estimates range from a high of $279 for a home freezer and $201 for a refrigerator to a low of $7 for a toaster and $8 for an iron. A desire for larger-size models to accommodate bigger families may account for the high average price of some items.

Interest in the purchase of appliances is high among all farm families but tends to increase with income as Table 35 shows. In the case of newer appliances, such as the home freezer, buying intent is much greater in the higher income brackets than in the lower ones, suggesting that the market pattern for these specialty lines will be similar to that previously experienced with refrigerators, washing machines, radios, etc.

TABLE 35

FARM FAMILIES WHO EXPECT TO BUY HOUSEHOLD APPLIANCES

(By income groups)

Income Group	Total Interviews	Owners	Tenants
Under $1,500....	62.7%	63.7%	59.6%
$1,500–$2,499....	67.0	66.9	67.5
$2,500–$4,999....	72.7	71.6	76.4
$5,000 and over..	71.2	71.2	71.2

Those farm families who expect to buy appliances are serious about their plans. Most of them will purchase such items at the first opportunity (Table 36). With the exception of mechanical dishwashers, from 62% to 76% plan

TABLE 36

PERIOD WHEN FARMERS EXPECT TO BUY HOUSEHOLD APPLIANCES

Type of Appliance	Within 2 Yrs. or as Soon as Available	After the War	3 Yrs. or More	Indefinite or Don't Know
Refrigerator....................	73.1%	7.5%	3.2%	16.2%
Range or cook stove............	75.5	9.7	3.6	11.2
Washing machine...............	76.1	6.6	3.6	13.7
Vacuum cleaner.................	73.7	8.9	4.3	13.1
Iron............................	71.4	6.5	2.4	19.7
Radio: without phonograph.......	72.9	11.2	1.3	14.6
Food mixer.....................	72.2	10.0	5.0	12.8
Quick or home freezer...........	62.6	8.9	6.5	22.0
Toaster.........................	72.3	7.4	2.4	17.9
Ironer (mangle).................	74.8	11.5	5.7	8.0
Radio: with phonograph..........	66.2	9.7	6.4	17.7
Dishwasher.....................	38.5	15.4	26.9	19.2

to buy these appliances within two years after they become available while additional consumer action will be stimulated by the ending of the war. Some are indefinite about the time or don't know, but only a very few will be inclined to postpone purchases longer than three years. In passing, however, it is to be noted that makers of mechanical dishwashers are confronted with the biggest promotional problem for their products.

Farmers expect to finance the greater portion of these appliance expenditures with their own funds (Chart 23). 82.8% state they will pay cash; 6.8% expect to use installment financing plans; 3.4% will buy on credit terms with dealers; and 0.6% will finance their purchases by a bank loan or mortgage. 9.1% are still undecided, and a few would employ a combination of these methods. Of these farmers 53.4% have already set aside or earmarked funds for this purpose mostly in the form of cash, war bonds or other liquid assets. Farm owners are in a slightly better position to pay cash for their appliance purchases than tenants.

CHART 23

HOW DO FARMERS PLAN TO PAY FOR THEIR PURCHASES OF HOUSEHOLD APPLIANCES?

	% Who Mention *
Cash	82.8%
Mortgage or bank loan	0.6
Time payments or finance	6.8
Dealer credit	3.4
Don't know	9.1

* 53.4% have already earmarked funds for this purpose.

AIR CONDITIONING

Farmers have not yet acquired a keen interest in home air conditioning equipment, and their desire for this type of appliance is distinctly limited. Only 7.2% of the farmers interviewed expect to buy home air conditioning equipment when it becomes available. Most of these potential purchasers are farm owners in the upper income brackets; tenant interest in the subject is negligible.

Of the farmers interviewed 69.2% say they will not buy such equipment; a majority of this group are not interested, think air conditioning is too expensive or has no place on the farm (Table 37). 23.6% of the farmers, however, are undecided, a fact which provides some ground for encouragement to the industry and also exposes the magnitude of the merchandising job that is necessary to build consumer acceptance. Considerable price education is also needed, for more than half of the group who expect to install air conditioning have no definite conception of its cost; those who do have some knowledge of cost expect to pay an average price of $189.

TABLE 37

WHY FARMERS DO NOT PLAN TO BUY AIR CONDITIONING EQUIPMENT

Reason Given	% Who Mention *
Not interested, unnecessary	42.6%
Too expensive	27.5
Impractical	11.7
Need other things	6.0
Miscellaneous	13.4
No reason	1.2

* Some gave more than one answer.

EXHIBIT 6

[The *Sales Management Survey of Buying Power*, an annual study of income and sales published by Sales Management, Inc., since 1930, provides statistical data covering estimates of population, total retail sales, sales by three major store groups, effective buying income (gross and net), gross farm income, wholesale sales, sales-advertising controls for the nation, sections, states, counties, and cities, plus special sections for Hawaii and the Dominion of Canada. It furnishes answers to such questions as: Where do people live? How much do they have to spend? How much do they spend? Where do they spend it, and for what?

From the *1947 Survey*[1], the editorial foreword and explanation of data, as well as excerpts from the figures for California, are reproduced below.]

SALES MANAGEMENT 1947 SURVEY OF BUYING POWER

Income in 1946 remained almost at the 1945 level, but retail sales soared to an all-time high, practically double the 1929 total which for many years during the depression thirties looked like a towering mountain peak.

Disposable income (gross less Federal income taxes) increased 6% to $140.9 billion, but retail sales soared from $74.5 billion to $96.5 billion, or a gain of 30%. Obviously much of the increase in sales came from savings. Last year's savings of $15.8 billion were the lowest since 1941, and only half of the 1945 total. The nation's dollars were spent and saved approximately as follows:

Federal taxes	$19.21 billion
Savings	15.80 billion
Retail sales	96.53 billion
Services, amusements, transportation, local taxes	28.65 billion

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[1] *Sales Management 1947 Survey of Buying Power* (New York, Sales Management, Inc., 1947), pp. 19–34, 422, 426, 440. Reproduced by permission.

In this 18th annual S.M. *Survey of Buying Power* the editors have made a change which they feel sure will meet with the approval of subscribers. In previous years county and city data sections were separated, and some of the information given for counties was not repeated for cities, and vice versa. This year the two sections are consolidated, and subscribers can see at a glance the importance of a city or cities as compared with the county. Identical information is given for both units, with the exception that farm income is given only for counties and wholesale sales only for cities.

A welcome addition for cities are the sales-advertising controls which heretofore have been available only for counties. Judging by the use-examples available to S.M. editors, probably the one most widely used column in the *Survey* is "% of U.S.A. Potential." Many subscribers have asked that this be given for cities. Their wish has been granted.

Subscriber response to last year's innovation of two effective buying income figures, gross and net, was most gratifying, and this feature has been continued. In 1946 because of a slight lowering in the income tax rate, the net figure is almost 88% of gross, while in 1945 it was less than 87%. This is the *national* rate. State ratios show a high degree of variance, with Federal taxes a much higher percentage of income in the highly industrialized states than where agricultural income is of primary importance.

The average family last year spent $2,500 in retail sales, with $617 going to food stores, $383 to general merchandise stores, $92 to drug stores. A marketing pictograph in the *Survey* gives the family expenditures in every type of store.

One of the most striking changes in the *Survey* is to be found in the population columns. We know all too little about the number and location of people today. We know that the nation has gained some 12 million people since the 1940 Census was taken. We know that millions of people moved about during the war years, coming from farms and villages to city war plants, that there were great sectional changes induced by war needs and opportunities. We know that the state-county-city estimates from 1942–1945 were shrunken because 10 million men and women were overseas.

Today the Government by a sampling method can determine national and state populations with a fair degree of accuracy, but practically no official data is available on county and city population. Because neither the 1940 figure nor the OPA count is of any value today, *Sales Management* has undertaken the task of making county and city estimates as of January 1, 1947.

Your editors do not advance these population estimates as being anything like 100% accurate. The best they can say for them is that they are better than the outdated 1940 and OPA figures, and probably are sufficiently accurate for general sales and advertising planning. But do not decide that City A is a better market than City B because it has a per-family effective buying income of $4,640 while B has only $4,575. The margin of error in the population estimates makes such precise comparisons of debatable value.

A complete description of the methods used in making county and city population estimates will be found in the following paragraphs.

Population Estimates, How Derived

New population estimates for counties and cities as of January 1, 1947, are advanced by your editors with some fear and trembling. Their accuracy is not guaranteed. Perhaps the best that can be said for them is that they are far more realistic than either the 1940 Census figures or the 1943 OPA count which omitted some 10 million men and women who were in the armed services.

The nation needs a new census of population, and until 1950 rolls around we can have only "guesstimates," which, very frankly, is a characterization that can be applied to the population figures in this *Survey*. *Sales Management* is not at all happy about them, but considers them the best that can be made at this time.

The procedure was as follows: The magazine asked postmasters and chambers of commerce in every city which is listed in the *Survey* to send estimates of January 1 population, covering civilian population within the municipal boundaries. Usually there was close agreement between the two estimates. Where they were close, S.M. averaged out a middle figure. Where the variation was wide, S.M. went back for added information from local sources.

Any increases in city populations over the preceding year were added to the country figure printed in the 1946 *Survey*, or subtracted if there was a decrease.

The next step was to determine from Bureau of Census estimates of state populations as of July 1, 1946, the increase or decrease for the state as a whole.

Then this rate of change was applied to the revised county figure.

Perhaps the procedure can be clarified by an example:

City X had 20,000 people in 1945 and 25,000 on January 1, 1947. The county in which it is located had 40,000 people in 1945.

The city gain of 5,000 people was added to the old county figure, giving us a new figure of 45,000.

The state, according to Census Bureau estimate, gained 10% in population.

So to the revised county figure of 45,000 was added the state 10% gain, making the final revised county figure 49,500.

Counties where there were no major cities received the over-all state increase of 10%.

The estimates for number of families was developed by this procedure: From U.S. Housing Volume 2, 1940, the S.M. editors took off for each county and city the median number of persons per occupied dwelling unit. This was then divided into the 1947 estimated population figure. The resultant tentative family total was greater than the Census Bureau's current estimate of the number of families in the nation, and all county and city family figures were then reduced by 9% to bring the national total in line with the Census Bureau's national estimate.

That's it, subscribers. It was the best we could do under the circumstances, and we are forced to say "Take it or leave it." We frankly label our figures as "guesstimates," but where are you going to find better ones? Unquestionably there is a margin of error, perhaps as much as 5%. If we show a county's population as 100,000, and a group of local experts say "No, it's 105,000," or "It's only 95,000," we shall not argue with them.

Always when the nation gets into the closing years of a decade, there is a lot of confusion about correct population figures. In 1939 and even in 1940 we were all forced to use county population figures from the 1930 Census. We knew they were antiquated but we had no new model. Today the situation is even worse because in addition to a bigger than average increase in population we have the shifts in population which were produced by the war.

RETAIL SALES, 1946 S.M. ESTIMATES

County figures are arranged alphabetically by states, and cities are indented. . . . Only those cities are included which had retail sales of $4 million or more in 1939.

In making its estimates of retail sales by states, counties and cities, *Sales Management* starts with the official 1939 Census figures as the base. Various factors are used in estimating the degree of change since that year, the main ones being (1) population growth or decline, (2) bank debits, (3) sales tax receipts where available, (4) sales of independent retailers as compiled for certain states by the Department of Commerce, (5) department store sales index of the Federal Reserve Board, (6) income tax payments, (7) agricultural marketings.

Especially through the studies which the magazine has made on the correlation between bank debits and retail sales—studies going back to 1929—is it possible to mark the direction and degree. These relationships between bank debits and retail sales vary from state to state and city to city.

The month-to-month changes in bank debits and retail sales are reflected monthly for more than 200 cities in the copyrighted feature, "High Spot Cities," which appears in each first-of-the-month issue of *Sales Management.* These continuing studies are extremely helpful in preparing the final annual estimates which appear in this volume.

Because much more information is available for large counties and cities than for small ones, the editors believe that a higher degree of accuracy in estimating both income and sales is possible for the large communities. For many of the smaller counties and cities no current data are available, and the Research Department has been forced to assume that the direction of change is similar to the larger areas of which they are a part.

The first column under "Retail Sales" is "Dollars (in thousands)," followed by "% of State" and "% of U.S.A." Similar percentage figures are given for population and effective buying income so that users of the *Survey* can see at a glance both the quantity (dollars) and the quality (percentages) factors of a given county or city, or as between counties and cities.

Estimates then follow for the 1946 dollar sales of three important store groups, selected both on the basis of total volume and of current business possibilities. In the 1948 edition two groups may be added—automotive and building materials—which have been omitted in recent years because shortages and allocations have made sales figures relatively meaningless.

The types of stores included under food, general merchandise and drugs follow the pattern laid down by the Bureau of the Census.

The food group takes in all stores selling food as a main item (groceries, meat markets, delicatessens, dairy products) but does not include country general stores.

General merchandise stores include department stores, mail-order stores and variety stores.

Drug stores are drug stores *only*. The estimates do not include the sales of drug items in department stores, super-markets or other stores that may sell some drugs or toilet goods as a sideline.

For the nation as a whole, retail sales account for 60% of *gross* income and 69% of *net* income, but the relationship varies widely from state to state and especially in counties and cities.

Some counties, and many cities, have retail sales which are greater than net effective buying income. This seldom means that the people in those communities are living beyond their incomes. Almost always it means that they draw retail trade heavily from a wide outside area.

EFFECTIVE BUYING INCOME, S.M. ESTIMATES

The first column under this heading shows in thousands of dollars the *gross* effective buying income for 1946 from all sources, including:

Wages
Salaries
Dividends
Interest
Government payments
All miscellaneous items of income

The income figure is for *income paid out, before taxes are paid.*

The estimate is based upon a formula first devised by *Sales Management* in 1939. It has been improved materially in recent years through correlation studies which show the relationship between income and retail sales, and between bank debits and both income and sales. As in the case of retail sales, the *Survey of Buying Power* is the *only* source for income estimates by counties and cities.

After estimating the national income with the cooperation of Department of Commerce experts, the income is apportioned to each state on the basis of information available through retail sales, income tax returns, bank debits, population changes, car loadings, agricultural payments, and the like.

The state income is then distributed by counties according to percentage figures based upon known relationships between the county and the state, including many of the factors mentioned in the preceding paragraph. Where there are important cities, the income is then broken down still further, based upon studies of the degree of importance which the city bears in the county's general economy.

From this gross figure is subtracted the estimated Federal income tax payment and that new total is net effective buying income, or *disposable* income. It is not possible to secure reliable data on the county-by-county and city-by-city income tax payments. Only state figures are available, and the assumption is made that the percentage paid by the state as a whole is applicable to all counties and cities. Common-sense reasoning tells us that deductions should be greater for the large highly industrialized areas and smaller for farm and rural areas, but no formula for making these logical adjustments is possible from available data.

Following the total dollar figure on net effective buying income come further refinements, and these, for the second year, are based on the *net* figure. Bear this in mind in making comparisons for issues *preceding* the 1946 *Survey of Buying Power.*

The per-family E.B.I. figure is a straight arithmetical average. We caution readers in its use for two reasons: because it *is* arithmetical rather than median, and because the population estimates for 1947 are advanced as subject to a considerable margin of error.

Your editors would like to be able to present you with a *median* average income figure, or groupings to show the number of families within the conventional standard income groups, but they are unable to secure reliable measuring rods.

In probably the majority of counties little difference would be found between an arithmetical and a median average. *Relatively* they would be similar.

But in many other counties great differences would be found. Let's say that a county has 10,000 families and a total net E.B.I. of $40,000,000. This works out to an arithmetical average of $4,000 per family.

It is possible, however, that five families have a total income of $2,000,000; 100 others a total income of another $2,000,000; 1,000 others a total income of $7,500,000, leaving $28,500,000 for the remaining 8,895 families, or an average for them of $3,204.

So, we suggest, do not take these per-family figures literally. They have value in a broad sense as denoting the quality of a market, but your editors believe that close distinctions, such as $4,500 as against $4,400, are relatively meaningless.

County and city net dollar figures are refined to show what percentage they bear to state and U.S.A. totals. Since similar percentages are shown for population and retail sales, subscribers can get the answer quickly to three vital questions: how *many* people; how *much* they spent; how much they *might* have spent.

Some subscribers, particularly research men and other technicians, may be left unsatisfied by the above description of how *Sales Management* makes its annual estimates. We regret that we cannot take them through each step and process.

To *Sales Management* the formulas and technique used in making these estimates for the annual *Survey of Buying Power* are an important and valuable stock in trade which must be safeguarded. Just as Macy's doesn't tell Gimbel's, just as P. & G. doesn't tell Colgate, so S.M. must refuse to tell all its secrets.

GROSS CASH FARM INCOME

For the fifth successive year the *Sales Management* Research Department has developed an estimate of *gross* farm income by counties. It is an estimate of the cash receipts from agricultural and livestock marketings, plus Government benefit payments. It does *not* include the farmer's income from off-the-farm labor or from investments.

The estimates for 1946 are not directly comparable with those of previous years because this year no attempt has been made to estimate the farmer's nonmoney income.

This nonmoney income varies widely in its over-all importance, and has changed so much since the 1940 Census that S.M.'s Research Director feels that any current estimates would have too high a margin of error. According to sectional estimates for the year 1944 made by the Department of Agriculture, 12.5% of the farmer's income is in kind. This includes free rent; field, garden and dairy products consumed in the home; fuel and ice gathered and consumed on the farm.

As a percentage of total gross income the sectional range in 1944 was as follows:

New England	14.7%
Middle Atlantic	15.0
East North Central	11.8
West North Central	8.8
South Atlantic	19.7
East South Central	24.6
West South Central	13.9
Mountain	7.3
Pacific	4.8

The 1946 estimates were arrived at by taking the Department of Agriculture preliminary figures on gross farm income by states and then distributing the total by counties according to the percentages which prevailed in the 1940 Census. There was not sufficient information available on a county-by-county basis to make possible any allowance for variable increases in either the price or the production of specific crops, or types of livestock, or in the *possible* shifting of a county's basic agricultural livelihood from the 1939 basic crop to a new one in 1946.

Because it is a *gross* estimate of farm income, the dollar total in this column will be found to exceed the effective buying income in a number of counties which are predominantly agricultural. The *net* agricultural income (after deduction of current operation expenses) has rather extreme variations from state to state.

SALES ADVERTISING CONTROLS

The column headed "% of U.S.A. Potential" is designed as an over-all index for use in setting sales quotas and advertising appropriations.

It is a weighted index and includes effective buying income, retail sales and population.

The number of people, their buying habits and the amount of money they have to spend are each important in setting sales quotas and allocating advertising appropriations, but for the great majority of products no single feature is an accurate guide. Perhaps we were all *created* equal, but we are not equal when we reach the buying stage; neither do we buy all of our merchandise in the same towns in which we live—and millions of us live on farms far away from towns.

As a result of a great deal of study and experimentation, and after checking tentative conclusions with actual sales records of many S.M. subscribers, the editors have perfected a new balanced "% of U.S.A. Potential" which assigns 5 points to "% of U.S.A. Effective Buying Income," 3 points to "% of U.S.A. Retail Sales," and 2 points to "% of U.S.A. Population."

This "% of U.S.A. Potential" figure can be used without change by national marketers in setting up sales quotas on a fair and equitable basis, in dividing up sales territories, in setting realizable goals for distributors by advertising agencies and by advertising departments in breaking down their appropriations and in deciding where to put added pressure.

Those organizations that do not distribute nationally but operate on a sectional basis can use the figures with a slight modification. Let's suppose that such a manufacturer operates in a dozen states and the combined "% of U.S.A. Potential" of these 12 states . . . is 25% of the national total. Since this is one-fourth of the U.S.A. potential, he should multiply the "% of U.S.A. Potential" for each county in his section by four.

Many alert sales organizations use these potential figures in their sales training and promotional work with important distributors and dealers, *but the editors suggest that all national figures be reduced to a local level.* The distributor in Richmond, Va., can't see the counties in his territory as a percentage of the *national* total, but it is very easy to reduce them to an understandable figure. Let's assume that this distributor has 5 counties in his territory. . . .

A typical setup follows: The first column shows the "% of U.S.A. Potential," . . . and the second column is the figure which results from using the total of the 5 counties (0.797) as the base, 100:

County	% of U.S.A. Potential	Localized County (%)
A	0.046%	5.77%
B	0.542	68.00
C	0.122	15.31
D	0.020	2.51
E	0.067	8.41
Total	0.797%	100.00%

That distributor can't visualize County B as producing 0.542% of the nation's total, but he can see it as having 68% of *his* territory's volume.

The last column [see table, page 176] called "Quality of Market Index," is a measure of the purchasing ability of each county and city as compared with the nation. It is constructed by dividing the "% of U.S.A. Potential" by "% of U.S.A. Population." The U.S.A. of course is the base, 100. This index is designed as a handy guide to sales and advertising managers who are considering intensive campaigns in a restricted list of above-average counties. Those counties and cities which have an index figure markedly higher than that of the nation (100), or higher than other counties and cities in the state or geographic area, are likely to be the ones where intensified promotional campaigns will bring the greatest returns. Note, however, that it is an index of *quality* but not of quantity.

. . . .

SUGGESTED USES FOR THIS SURVEY

1. ADVERTISING
    - *a.* Allocating by districts
    - *b.* Checking media circulations against income and sales
    - *c.* Servicing agency accounts
    - *d.* Determining markets for intensive cultivation
    - *e.* Selecting test cities
    - *f.* Adjusting advertising quotas to sales results
    - *g.* Selecting cities for special spot radio and newspaper campaigns

2. MARKET PLANNING
    - *a.* Determining market potentials
    - *b.* Setting quotas for a new product or industry
    - *c.* Checking relative merits of distributors
    - *d.* Setting territorial quotas
    - *e.* Furnishing spending power data to dealers
    - *f.* Determining markets for test of new products or plans
    - *g.* Appointing exclusive distributors
    - *h.* Measuring progress or retrogression of specific areas
    - *i.* Planning expansion programs
    - *j.* Synchronizing production to absorptive power of the market

3. HANDLING THE INDIVIDUAL SALESMAN
    - *a.* Setting sales quotas
    - *b.* Checking salesmen's results against potentials
    - *c.* Offsetting salesmen's and distributors' alibis and hard luck stories
    - *d.* Revamping salesmen's route lists
    - *e.* Selling the salesmen on their territories

4. OTHER USES
    - *a.* Attracting factories and distributors' branches
    - *b.* Building bases for raising new capital
    - *c.* Planning expansion programs
    - *d.* Opening new, company-owned retail sales outlets
    - *e.* Locating industrial sites
    - *f.* Proving need for improved transportation service

PACIFIC STATES—CALIFORNIA

(SM marks original, exclusive estimates by Sales Management)

Counties Cities	Population SM Estimates 1/1/47				Retail Sales—1946 SM Estimates						Wholesale Sales	Effective Buying Income—1946 SM Estimates						Sales-advertising Controls	
								Three Store Groups (in thousands of dollars)											
	Total (in thousands)	% of State	% of U.S.A.	Families (in thousands)	Dollars (in thousands)	% of State	% of U.S.A.	Food	General Mdse.	Drug	1946 SM Estimate Dollars (in thousands)	Gross Dollars (in thousands)	Net Dollars (in thousands)	% of State	% of U.S.A.	Per Family	Gross Farm Dollars (in thousands)	% of U.S.A. Potential	Quality of Market Index
Alameda	744.6	8.10	0.533	251.0	925,307	10.53	0.959	217,486	182,515	30,156	......	1,255,150	1,071,898	9.29	0.760	4,271	35,505	0.774	145
Oakland	400.9	4.36	0.287	140.3	568,108	6.47	0.589	147,438	148,524	21,013	340,860	782,535	668,285	5.79	0.474	4,763	......	0.471	164
Berkeley	100.0	1.09	0.072	33.7	103,226	1.18	0.107	31,653	12,352	5,850	24,698	195,442	166,907	1.45	0.118	4,953	......	0.106	147
Alameda	89.9	0.98	0.064	29.2	26,316	0.30	0.027	10,657	1,235	1,662	6,360	120,627	103,015	0.89	0.073	3,528	......	0.057	89
San Leandro	22.9	0.25	0.016	6.7	11,402	0.13	0.012	4,045	1,020	568	4,380	34,145	29,160	0.25	0.021	4,352	......	0.017	106
Hayward	8.2	0.09	0.006	2.5	22,050	0.25	0.023	4,680	1,782	643	8,326	14,629	12,493	0.11	0.009	4,997	......	0.013	217
Alpine	0.2	....	.....	0.1	71	....	.....	......	......	.....	......	183	156	....	.....	1,560	323		
Amador	7.2	0.08	0.005	2.5	8,089	0.09	0.008	2,284	153	329	......	10,903	9,312	0.08	0.007	3,725	3,432	0.007	140
Butte	49.7	0.54	0.035	16.8	41,094	0.47	0.043	12,393	5,522	1,144	......	58,197	49,700	0.43	0.035	2,958	25,488	0.037	106
Chico	12.0	0.13	0.009	4.0	22,395	0.25	0.023	4,844	3,430	645	4,776	19,626	16,761	0.14	0.012	4,190	......	0.015	167
Oroville	5.7	0.06	0.004	2.2	11,251	0.13	0.012	3,823	1,687	304	......	4,924	4,205	0.04	0.003	1,911	......	0.006	150
Calaveras	7.3	0.08	0.005	2.6	6,620	0.08	0.007	1,983	1,056	256	......	8,955	7,648	0.07	0.005	2,942	3,497	0.006	120
Colusa	10.1	0.11	0.007	3.3	9,747	0.11	0.010	2,296	920	414	......	13,402	11,445	0.10	0.008	3,468	16,224	0.008	114
Contra Costa	235.6	2.56	0.169	71.4	81,419	0.93	0.084	25,220	8,101	2,885	......	158,692	135,523	1.18	0.096	1,898	23,777	0.107	63
Richmond	93.7	1.02	0.067	29.4	46,518	0.53	0.048	18,608	3,165	1,814	9,553	95,247	88,713	0.78	0.063	3,017	......	0.059	88
Pittsburg	10.8	0.12	0.008	3.1	10,350	0.12	0.011	2,488	2,007	438	4,968	10,128	8,503	0.07	0.006	2,743	......	0.008	100
Martinez	12.5	0.14	0.009	4.1	11,179	0.13	0.012	3,065	1,520	548	1,711	8,955	7,648	0.07	0.005	1,865	......	0.008	89
Del Norte	4.0	0.04	0.003	1.5	4,465	0.05	0.005	1,262	195	122	......	5,889	5,029	0.04	0.004	3,353	1,592	0.004	133
El Dorado	11.4	0.12	0.008	4.2	10,801	0.12	0.011	4,316	*	195	......	14,265	12,182	0.11	0.009	2,900	5,530	0.009	113
Fresno	219.5	2.39	0.157	64.4	205.477	2.35	0.213	48,533	24,355	6,626	.....	285,346	243.685	2.11	0.173	3,784	159,889	0.182	116
Fresno	63.7	0.69	0.046	19.3	142,515	1.62	0.148	25,075	18,153	4,559	157,857	105,513	90,108	0.78	0.064	4,669	......	0.086	187
Glenn	12.5	0.14	0.009	3.8	11,748	0.13	0.012	2,921	669	292	......	15,595	13,318	0.12	0.009	3,505	20,668	0.010	111

* Withheld to avoid disclosure

EXHIBIT 7

[*Industrial Distribution and Marketing* is a study prepared in 1945 by the Marketing Research Staff of the trade magazine *Mill Supplies* for the use of manufacturers of industrial products in charting and maintaining a basic selling and distribution plan. Reproduced below are the abstract which was enclosed and several sample pages of statistical data.]

INDUSTRIAL DISTRIBUTION AND MARKETING SALES PLANNING BASED ON STATISTICS FOR THE YEAR 1939

The bulk of the statistical data presented by *Mill Supplies* in this book, *Industrial Distribution and Marketing*, was taken from the Census of Manufacturers and covers the year 1939. The pertinent data from this source which have significance for sales planning and management purposes have been brought together in a highly usable form, tailored to the needs of manufacturers selling the industrial market. As such, the market facts appearing herein represent the most comprehensive regional measure of the sales potentials for industrial equipment and supplies that are currently available.

The question will be asked: Why use figures that relate to operations in 1939? Did not the war distort the industrial market so that prewar geographic potentials are no longer valid? We naturally asked ourselves these questions. But from the information at hand from various sources we are convinced that careful use of the statistical material supplied here will give accurate results for purposes of establishing geographical potentials. Three reasons for this judgment may be briefly cited:

1. The year 1939 was the last annual period of peacetime business before defense activity and then war production modified the picture. It is also the last year covered by complete Census data. As war activity is deflated there will certainly be a tendency for geographic industrial concentration to resume its prewar pattern. To be sure, some regions that experienced exceptional wartime booms will not return to their former relative positions. These regions, however, are well known and may be handled through adjustments on an individual basis. In any event, they represent only a relatively few areas while by far the greatest number of industrial areas can be handled on a regular basis.

2. The tremendous wartime expansion of industrial facilities, contrary to common belief, did *not* result in any wholesale relocation of American industry. The official records of manufacturing plant expansion has recently been made available in a WPB study, *The Geographic Distribution of Manufacturing Facilities Expansion.* To quote from the conclusions of this careful study prepared by competent WPB statisticians with all the records before them:

> Military and economic consideration resulted in a heavy concentration of these war expansions in the same states and areas where specific industries had chiefly operated before the war. This conclusion runs counter to impressions that a wide-

spread relocation of industrial plants has occurred. Actually, effective dispersion has been the exception rather than the rule.

The very size and rapidity of this over-all expansion would have been impossible had not full advantage been taken of existing facilities, concentrations of labor force and technical staffs, transportation routes, power lines, and the location of developed natural resources. Without minimizing the considerable effort made to establish munitions industries in areas not previously given to large-scale manufacturing or the equally great effort made to harness all types and sizes of factories to war production through subcontracting, the bulk of expansions occurred in those geographic areas where manufacturing had been well established before the war.

3. The consistency of the prewar and wartime pattern of geographic concentration of industry may be demonstrated by the use of data from another and independent source; namely, by comparing the percentage distribution of workers employed in manufacturing industries among the various geographic areas in 1939 and again in 1945.

The usual practice in establishing potentials for geographic areas involves the reduction of the measure selected (value of product, employees, per capita income, etc.) to a percentage of the national total for that measure in each region. Since we are interested in calculating sales potentials for industrial equipment and supplies, we want some measure of industrial activity for which a geographic breakdown is available. The number of workers employed in manufacturing industries appears to be the best available guide for this purpose. From past experience, we know that the number of workers employed and the volume of manufacturing activity correlate very closely. And we also know that as the curve of manufacturing activity moves up and down, sales of industrial equipment and supplies follow closely on a parallel course.

Using basic data from the Bureau of Labor Statistics, we have calculated the percentage distribution of the number of wage earners in manufacturing industries in 1939 and again in 1945 for 92 of the most important metropolitan areas in the United States. (These are the 100 metropolitan area data of the B.L.S., but the 8 metropolitan groups have been omitted; only the individual cities in the groups have been used.) Employment in these areas accounted for a little less than half of all manufacturing employment in 1944. From this calculation it is possible to detect any significant changes that may have occurred over the period in the relative importance of various metropolitan areas as centers of manufacturing activity.

Picking a few areas at random for purposes of illustration, Chicago accounted for 9.08% of the 100-city total in 1939 while it accounted for 9.09% of the total in July, 1945—a plus change of 0.01 percentage points. During this period, of course, there was a very significant increase in total employment, but Chicago maintained the same relative importance. Or again, Philadelphia accounted for 6.57% in 1939 and 6.10% in July, 1945—a minus change of 0.47 percentage points.

The actual changes in percentage points for the 92 metropolitan areas are shown in the following tabulation:

Change in Percentage Points, 1939–1945	Number of Cities
Over 1.00	2
+0.75–1.00	0
+0.50–0.75	0
+0.25–0.50	6
0.00–0.25	36
No change	4
0.00– −0.25	36
−0.25– −0.50	4
−0.50– −0.75	0
−0.75– −1.00	3
Over −1.00	1
	92

From this table it is seen that 76 of the areas, or 83%, experienced changes in their percentage ratings of plus or minus ¼ of 1% or less. San Francisco showed the largest plus change in its relative percentage standing, moving from 1.41% of the total in 1939 to 2.94% in July, 1945—a gain of 1.53 percentage points. New York, on the other hand, showed the largest minus change, dropping from 16.19% of the total in 1939 to 14.10% in July, 1945—a drop of 2.09 percentage points. These were the extremes.

The point is that the great majority of the metropolitan areas did not experience significant changes in their relative percentage standings. Industrial markets in July, 1945, were almost exactly the same as they were in 1939. Chicago, for example, was important before the war, it maintained its relative position during the wartime boom, and, as we return to peace, it will still be important and, in all probability, at very nearly the same relative level.

The fact that any true (?) sales potential of an area (if it could be computed and if nonexistent figures were available) might vary one-tenth or one-quarter or even one-half a percentage point in 1946 or 1947 from the figures for 1939 shown in this book is not too important. There is too large and widely varying a human element involved in selling to quibble over a tenth of a percentage point in setting sales potentials. The important thing is to start setting potentials on a scientific and objective basis rather than in terms of guesses spiced with past performance figures that reflect what was done and not what should have been done.

BREAKDOWN OF BASIC INDUSTRY GROUPS

Manufacturing Establishments, Wage Earners and Value of Products

Industry Group	Number of Manufacturing Establishments	Percentage of Total	Wage Earners (Average for the Year)	Percentage of Total	Value of Manufactured Products	Percentage of Total
1. Food and kindred products....	51,448	27.48	823,793	10.25	$10,618,025,930	18.62
2. Iron, steel, and their products (except machinery)..........	8,994	4.88	966,567	12.05	6,591,530,456	11.60
3. Automobiles and automobile equipment..................	1,133	0.62	399,063	5.06	4,074,872,729	7.17
4. Textile mill products.........	6,293	3.42	1,082,802	13.43	3,897,437,872	6.86
5. Chemicals and allied products..	9,203	5.00	287,136	3.64	3,733,657,723	6.57
6. Apparel and other finished fabric products..............	20,357	11.50	751,427	9.43	3,358,255,400	5.92
7. Machinery (except electrical)..	9,506	5.16	522,980	6.53	3,254,173,950	5.72
8. Products of petroleum and coal	989	0.57	105,428	1.33	2,953,973,409	5.90
9. Printing, publishing, and allied industries..................	24,878	13.50	324,635	4.09	2,578,464,382	4.54
10. Nonferrous metals and their products....................	5,600	3.04	228,573	2.89	2,572,854,496	4.52
11. Paper and allied products.....	3,279	1.77	264,716	3.36	2,019,568,217	3.54
12. Electrical machinery..........	2,014	1.09	256,467	3.25	1,727,389,949	3.04
13. Stone, clay, and glass products	7,024	3.82	287,522	3.65	1,440,151,489	2.53
14. Leather and leather products..	3,508	1.90	327,663	4.12	1,389,513,718	2.45
15. Tobacco manufacturers.......	765	0.42	87,525	1.11	1,322,189,139	2.32
16. Furniture and finished lumber products....................	8,457	4.58	293,570	3.72	1,267,724,013	2.23
17. Lumber and timber basic products........................	11,520	6.25	360,661	4.53	1,122,057,978	1.99
18. Rubber products.............	595	0.32	120,740	1.53	902,328,802	1.60
19. Transportation equipment (except automobiles)............	968	0.55	157,097	2.00	882,896,840	1.55
20. Miscellaneous industries......	7,699	4.13	238,827	3.03	1,162,958,308	2.04
Total........................	184,230	.....	7,887,242	.....	$56,843,024,800	

BREAKDOWN OF BASIC INDUSTRY GROUPS

Percentage of National Volume by Geographical Districts

Industry Group	New England	Middle Atlantic	E.N. Central	W.N. Central	South Atlantic	E.S. Central	W.S. Central	Mountain	Pacific
1. Food and kindred products	4.00	21.02	26.80	17.85	6.38	3.30	6.49	2.81	10.99
2. Tobacco manufactures	3.77	11.51	2.55	2.00	71.25	6.00	0.49	0.14	0.78
3. Textile mill products	27.00	28.70	5.46	0.06	30.30	5.56	0.70	0.06	1.00
4. Apparel and other finished fabric products	7.00	58.00	13.62	4.80	6.27	2.82	1.99	0.23	3.82
5. Lumber and timber basic products	3.06	4.79	10.26	4.29	15.58	12.25	11.12	4.25	35.70
6. Furniture and finished lumber products	7.31	20.95	32.01	5.49	13.82	5.48	4.76	1.42	8.82
7. Paper and allied products	17.20	22.91	31.00	3.59	9.40	2.34	3.35	0.14	8.56
8. Printing, publishing, and other allied industries	7.22	37.19	28.50	7.76	5.90	2.19	3.19	1.58	6.90
9. Chemicals and allied products	5.00	35.64	24.76	5.15	13.54	5.96	4.44	0.93	5.09
10. Products of petroleum and coal	0.02	22.03	21.00	4.15	2.29	2.46	31.68	2.08	12.90
11. Rubber products	13.85	14.56	54.16	1.87	3.98	3.21	0.27	0.19	6.89
12. Leather and leather products	27.66	29.19	22.56	10.07	5.50	2.43	0.74	0.23	1.06
13. Stone, clay, and glass products	5.32	30.51	29.52	8.60	10.86	3.88	4.50	1.92	6.37
14. Iron, steel, and their products (except machinery)	5.70	31.52	43.97	2.53	7.05	4.55	1.03	1.00	3.72
15. Nonferrous metals and their products	22.40	34.77	21.41	2.35	2.67	2.77	1.50	7.00	4.32
16. Electrical machinery	14.57	36.00	40.15	3.75	1.40	0.07	1.30	0.02	2.19
17. Machinery (except electrical)	11.20	21.75	51.00	6.10	1.80	0.90	2.46	0.35	3.73
18. Automobiles and automobile equipment	0.60	10.72	75.22	4.03	2.21	1.54	1.14	0.12	3.05
19. Transportation equipment (except autos)	8.98	32.00	16.50	2.40	14.00	1.73	1.15	0.23	22.02
20. Miscellaneous industries	15.23	48.09	25.20	4.90	3.02	0.90	0.73	0.43	2.51

PRODUCERS SELL THROUGH DISTRIBUTORS BECAUSE IT'S GOOD BUSINESS

The distribution of industrial products consists of all the acts (functions) of getting a product from the place it is made to where it is put to a useful purpose.

WHAT DOES IT INVOLVE?

1. The finding, developing, selling and servicing of markets
2. Warehousing
3. Securing and then the filling, packing and shipping of orders out of stock
4. Customers credits, billing and collection.

Whether a manufacturer chooses to sell his products to the industrial market through the distributor, by mail, or through his own personal sales force—every act and function in the distribution process remains the same.

WHY SELL THROUGH THE DISTRIBUTOR?

A manufacturer can shift the major burden of warehousing. Generally, the manufacturer moves his product directly from the production line to the distributor's warehouse—maintaining a minimum stock inventory for emergency purposes.

He can utilize the efforts of a compact sales organization of his own to marshal the strength of a thousand, or more, distributor salesmen to sell his product in every industrial area that offers a market. The only way the average manufacturer with a product of general use can effectively sell the industrial market is through the distributor. That may be proved by simple arithmetic. The distributor offers sales-manpower wherever a market exists.

He reduces his orders to the requirements of a hundred or so distributors—large, easily handled shipments instead of thousands of orders, both large and small, from customers all over a country.

He shifts the burden of billing and collection, as well as the credit risks, of thousands of accounts to the distributor, thus reducing his own billing and collection problems to the hundred or so distributors he has appointed.

When it comes to selling equipment, tools, and supplies to industry, it pays to use the sales and service facilities of America's 2,200 industrial distributors. They provide the only economical and effective sales channel into all industry—from giant plants in larger cities to sawmills, construction projects, mines, and smokestacks on faraway trails.

THIS IS THE AVERAGE INDUSTRIAL DISTRIBUTOR

3½ trucks
$160,000 value of inventory
6 outside representatives and engineers—consultants
Rate of turnover 8 times annually
5 inside telephone order expediters
45 years in business
110 orders per day
898 accounts actively serviced

Local Plants Buy from Distributors Because It's Good Business

It is more convenient to buy from the industrial distributor because:

He offers immediate delivery from local stocks and emergency service which prevents possible costly shut-downs.

He enables the user to purchase immediate requirements and gives store-door delivery, saving transportation costs.

He offers immediate price and catalog information.

He keeps the buyer up-to-date on new products and new methods, and provides valuable personal service because of his wide knowledge of users' maintenance and production requirements.

He gives immediate service on adjustments and complaints and offers superior credit facilities.

He saves time and cost in customers' purchasing and accounting departments by consolidation of many items on one order.

It is more economical to buy from industrial distributors. For industrial plants to buy individual items direct from many manufacturers—often hundreds of miles away—is extremely impractical and expensive for both buyer and seller. The detail work in itself is both costly and overwhelming.

The industrial distributor serves as a supply point to which industrial orders flow. The buyer may consolidate orders for many items in one order to be filled immediately from the distributors' stocks.

Buyers who elect to buy direct, as some do, must buy in large quantities and must maintain sufficient plant inventories on many items to tide them over until manufacturer shipments arrive. But plant stocks are costly in investment, storekeeping expense and obsolescence (averaging 10.55%—see *Mill Supplies*, November, 1942). Is it any wonder that most buyers prefer to rely upon their local distributors, no farther away than the telephone?

One Source of Information Instead of Many Sources of Information

The local distributor's catalog (usually several hundred pages) is the buyer's bible of information on hundreds of essential, yet diversified items, classified and described in one convenient volume.

One Personal Contact Instead of Many Personal Contacts

The war plant buyer deals with one man, the distributor's representative, saving himself the time of interviewing many, many manufacturer's men. The buyer normally has a close, personal relationship with the distributor's man.

One Purchase Order Instead of Many Purchase Orders

In terms of manpower saved in the purchasing department, there are measurable savings in the fact that a single purchase order served on the distributor does the work of the several necessary to buy direct.

ONE INVOICE INSTEAD OF MANY INVOICES

Distributor-bought items are grouped on one invoice, as contrasted to one on each of many invoices the consumer receives when he buys direct from the manufacturer.

LOCAL PLANTS PREFER TO BUY FROM DISTRIBUTORS

Percentage of plants buying from industrial distributors—based on an independent survey made among industrial buyers in a typical industrial area.

Abrasives—coated	83.0%
Bars—sheets and shapes	83.1
Bearings—plain	85.1
Bearings—anti-friction	85.2
Belts—conveyor	65.9
Belts—transmission	73.6
Belts—V	84.2
Bolts and nuts	82.8
Brushes and brooms	70.6
Casters	81.0
Chains	76.6
Compressors	39.3
Cordage	79.7
Drills and reamers	88.5
Files	93.6
Hand tools—mechanic's	91.7
Hangers	89.6
Hoists—chain	74.1
Hoists—electric	60.2
Hose	78.5
Jacks	89.1
Lamps	77.7
Light machine tools	79.6
Machine tool—accessories	74.3
Motors	62.7
Oils and greases	37.9
Packing	76.2
Paint	61.7
Pipe	86.1
Pulleys	86.3
Pumps	47.8
Saws—circular and band	81.0
Saws—hack	94.9
Screws—machine	91.2
Screws—sockets	91.8
Sheaves	82.2
Steam specialties	84.9
Taps and dies	64.9
Tools—portable electric	73.4
Tools—portable pneumatic	54.3
Valves—fittings	85.7
Welding—parts, supplies	77.9
Welding rods	70.5
Wheelbarrows	92.7
Wheels—grinding	69.7
Wheels—wirebrush	90.0
Wire rope	84.1

A Word about Costs

Some figures on what it costs the industrial distributor to do business—how his income dollar is divided—will be found in the five-year averages below (from reporting members of the National Supply and Machinery Distributors' Association).

It is important to note that these are all essential and inescapable costs which enter into a manufacturer's distributing and sales expense whether or not he sells direct or through the industrial distributor.

The price at which the industrial distributor buys from the manufacturer must be, of course, low enough to give him a "living margin"; sometimes it *looks* to be considerably below what the manufacturer could get for his product direct from the industrial user. But when bookkeeping, credit, office, sales and engineering help, warehousing, deliveries, overhead, and all the rest are taken into consideration, it will be found that the industrial distributor more than earns his share of the sales dollar. He keeps selling expense at a minimum, provides service that builds good will and in many other ways contributes to the efficiency of our American system of distribution.

Merchandise

Most of the distributor's dollar goes to buy merchandise. Remember that this is a much lower cost than the consumer can obtain by buying direct, because the distributor gets a discount for performing certain basic functions for manufacturers.. 77.67¢

Administrative

Administrative, bookkeeping, wages, office costs, priorities service, credit, etc. These have been reduced to routine, low-cost operations, using modern business machines wherever possible. Priorities have stepped up costs, but the distributor's knowledge of priorities is extremely valuable to his customers 7.15¢

Sales and Engineering Service

Compensation paid, plus the cost of inside-the-house engineering service rendered industrial plants.................................... 5.45¢

Warehousing and Delivery Service

Operation and repair of warehouse, stock clerks' wages and operation of delivery trucks.. 3.66¢

Rent, Real Estate, Taxes, Insurance

Distributors are usually located in low-cost districts, where fixed costs are generally low.. 3.15¢

Profit

Reflecting a relatively small return on investment................ 2.92¢

Distributor Sales and Operating Statistics

Region and State	Number of Industrial Distributors 1945	Number of Industrial Distributors 1939	Sales 1939 (add 000)	Operating Expenses 1939 (add 000)	Number of Employees 1939
United States	2,186	1,762	$873,892	$145,639	52,714
New England	174	135	41,343	8,812	2,802
Maine	13	12	4,389	991	305
New Hampshire	7	8	1,138	234	79
Vermont	10	9	1,356	274	97
Massachusetts	81	61	19,317	4,214	1,312
Rhode Island	18	13	2,778	610	206
Connecticut	45	32	12,415	2,489	803
Middle Atlantic	472	403	138,081	27,399	8,666
New York	218	181	65,463	14,335	4,151
New Jersey	76	70	15,238	2,998	1,085
Pennsylvania	178	152	57,380	10,066	3,430
East North Central	428	323	186,813	32,756	11,086
Ohio	121	96	65,510	11,354	3,855
Indiana	47	41	23,914	4,796	1,504
Illinois	99	75	40,840	6,241	2,171
Michigan	116	78	37,984	6,406	2,065
Wisconsin	45	33	18,565	3,595	1,491
West North Central	197	169	123,895	21,081	9,282
Minnesota	40	36	39,251	6,339	2,800
Iowa	29	25	9,294	1,769	641
Missouri	64	57	61,251	10,549	5,009
North Dakota	4	*	*	*	*
South Dakota	6	9	1,268	261	90
Nebraska	13	11	6,159	1,232	433
Kansas	41	31	6,672	931	309
South Atlantic	264	215	114,053	17,764	6,526
Delaware	4	4	1,594	434	122
Maryland	28	25	10,796	1,698	647
District of Columbia	12	6	11,000	1,364	536
Virginia	45	38	20,039	2,645	1,085
West Virginia	48	33	15,098	2,296	794
North Carolina	32	27	13,113	2,355	947
South Carolina	19	19	9,245	1,417	534
Georgia	38	31	13,932	2,339	835
Florida	38	32	16,236	3,216	1,026
East South Central	109	100	76,628	12,000	4,836
Kentucky	34	32	28,613	4,709	1,821
Tennessee	33	28	17,328	2,914	1,069
Alabama	23	25	26,480	3,579	1,608
Mississippi	19	15	4,207	798	338

DISTRIBUTOR SALES AND OPERATING STATISTICS (*Continued*)

Region and State	Number of Industrial Distributors 1945	Number of Industrial Distributors 1939	Sales 1939 (add 000)	Operating Expenses 1939 (add 000)	Number of Employees 1939
West South Central....	220	153	57,266	7,870	2,594
Arkansas.	11	10	5,553	695	226
Louisiana........	48	31	15,549	2,432	739
Oklahoma....	34	30	7,750	1,211	355
Texas..........	127	82	28,594	4,532	1,274
Mountain......	108	98	39,648	6,373	2,089
Montana...	15	18	6,003	961	264
Idaho...........	9	6	3,709	518	212
Wyoming......	8	8	1,525	94	19
Colorado.....	28	21	10,023	1,657	549
New Mexico.... ..	18	10	3,856	359	113
Arizona........	14	22	6,622	1,083	418
Utah......... ..	13	10	7,473	1,611	486
Nevada........	3	3	437	90	28
Pacific...............	214	166	96,115	14,463	4,833
Washington........	52	43	19,844	3,917	1,234
Oregon.............	42	26	9,550	1,957	561
California..........	120	97	66,721	8,589	3,038

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* Insufficient data.

EXHIBIT 8

[The *Industrial Market Data Handbook*, as such, was first published by the U.S. Bureau of Foreign and Domestic Commerce in 1939. In 1929, both consumer and industrial market data appeared in one volume, the *Market Data Handbook.* As in the case of the consumer volume, a new issue is expected to appear as soon as postwar census data are available.

The following excerpts[1] are a sample of the information available by states, counties, and cities and by type of industry.]

INDUSTRIAL MARKET DATA HANDBOOK

TABLE I

SUMMARY FOR MANUFACTURING INDUSTRIES, 1935, BY STATES AND COUNTIES

State and County	Number of Establishments	Percent of All Manufacturing Establishments in State and United States		Average Number of Wage Earners[a]	Wages (dollars)	Cost of Materials, Fuel, and Power[b, c] (dollars)	Value Added by Manufacture (dollars)	Value of Products[b, c] (dollars)
		State	United States					
Massachusetts—total.......	8,316	100.0	4.9	442,649	445,830,970	1,075,397,946	1,019,991,649	2,095,389,595
Barnstable....	20	0.3	d	102	101,662	114,003	241,395	355,398
Berkshire.....	163	2.0	0.1	15,299	14,451,689	27,226,369	32,155,010	59,381,379
Bristol.......	727	8.8	0.4	56,223	46,967,833	88,707,174	87,689,914	176,397,088
Dukes.......	2	d	d	e	e	e	e	e
Essex........	1,026	12.3	0.6	74,354	72,804,609	155,171,776	148,143,856	303,315,632
Franklin......	96	1.2	0.1	4,615	4,524,873	8,238,537	11,001,744	19,240,281
Hampden.....	595	7.2	0.3	40,537	42,836,547	96,234,243	100,481,032	196,715,275
Hampshire....	101	1.2	0.1	5,403	4,898,850	8,728,240	10,023,242	18,751,482
Middlesex....	1,484	17.8	0.9	77,641	79,454,264	254,113,462	204,605,299	458,718,761
Nantucket....	3	d	d	e	e	e	e	e
Norfolk......	391	4.7	0.2	21,144	25,041,409	60,091,074	55,751,214	115,842,288
Plymouth....	335	4.0	0.2	16,347	15,983,623	37,272,483	33,046,699	70,319,182
Suffolk.......	2,324	27.9	1.4	57,138	63,407,095	188,979,970	181,236,968	370,216,938
Worcester....	1,049	12.6	0.6	73,827	75,329,102	150,493,124	155,515,200	306,008,324
All other[f]....	5	g	g	19	29,414	27,491	100,076	127,567

[a] Not including salaried officers and employees. The figure for wage earners is an average of the numbers reported for the several months of the year. In calculating it, equal weight must be given to full-time and part-time wage earners (not reported separately), and for this reason it exceeds the number that would have been required to perform the work done in the industries if all wage earners had been continuously employed throughout the year. The quotient obtained by dividing the amount of wages by the average number of wage earners cannot, therefore, be accepted as representing the average wage received by full-time wage earners.

[b] Profits and losses cannot be calculated from the Census figures because no data are collected for certain expense items, such as interest, rent, depreciation, taxes, insurance, and advertising.

[c] The aggregates for cost of materials and value of products include large amounts of duplication due to the use of the products of some industries as materials by others. For the United States as a whole, this duplication amounts to about one-third of the gross value of products.

[d] Less than one-tenth of one per cent.

[e] Withheld to avoid disclosing approximations of data for individual establishments.

[f] Dukes and Nantucket.

[g] The "All other" figures for number of establishments and a part of the "All other" figures for number of wage earners are included above in the items for the respective counties. The sums of the figures in the first two columns are, therefore, larger than the corresponding state totals.

Source: Figures giving number of establishments, average number of wage earners, wages, cost of materials, fuel and power, value added by manufacture, and value of products were specially compiled by the Bureau of the Census from original schedules of the Census of Manufactures, 1935.

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[1] Adapted from U.S. Bureau of Foreign and Domestic Commerce, Domestic Commerce Series No. 107, *Industrial Market Data Handbook* (Washington, D.C., U.S. Government Printing Office, 1939), pp. 54, 103, 107–108, 133, 381–385.

TABLE 2

MANUFACTURING INDUSTRIES—SUMMARY FOR CITIES OF 10,000 POPULATION AND OVER, BY GEOGRAPHIC DIVISION AND STATES

Division, State, or City (All totals refer to cities of 10,000 and over)	Number of Establishments	Percent of All Manufacturing Establishments in State and United States		Average Number of Wage Earners[a]	Wages (dollars)	Cost of Materials, Fuel, and Power[b c] (dollars)	Value Added by Manufacture (dollars)	Value of Products[b c] (dollars)
		State	United States					
Massachusetts—total[d].......	7,387	100 0	6 3	376,270	379,293,165	918,970,184	883,323,551	1,802,293,735
Adams.........	21	0.3	[e]	2,746	2,149,131	3,389.835	3,184,763	6,574,598
Amesbury......	23	0.3	[e]	2,118	2,050,993	3,719,689	4,114,401	7,834,090
Arlington.....	25	0.3	[e]	106	124,511	289,309	363,373	652,682
Athol..........	30	0.4	[e]	1,820	1,587,110	2,655,907	3,802,857	6,458,764
Attleboro......	109	1.5	0.1	4,771	4,836,191	11,809,657	9,945,534	21,755,191
Belmont.....	6	0.1	[e]	19	17,135	25,423	63,266	88,689
Beverly.......	32	0.4	[e]	3,089	3,949,068	2,307,663	6,497,474	8,805,137
Boston.......	2,193	29.7	1.9	52,284	58,920,009	178,913,294	171,836,232	350,749,526
Braintree......	17	0.2	[e]	940	[f]	[f]	[f]	[f]
Brockton.......	206	2.8	0.2	9,647	9,381,432	21,498,575	18,299,901	39,798,476
Brookline......	21	0.3	[e]	362	333,353	393,977	1,020,747	1,414,724
Cambridge......	352	4.8	0.3	16,665	17,560,609	53,076,387	63,690,481	116,766,868
Chelsea.......	106	1.4	0.1	4,298	4,242,533	9,046,075	9,482,856	18,528,931
Chicopee.......	49	0.7	0.1	7,108	7,879,874	26,184,354	17,042,931	43,227,285
Clinton........	26	0.3	[e]	1,755	1,506,671	2,849,994	2,951,835	5,801,829

[a] Not including salaried officers and employees. The figure for wage earners is an average of the numbers reported for the several months of the year. In calculating it, equal weight must be given to full-time and part-time wage earners (not reported separately), and for this reason it exceeds the number that would have been required to perform the work done in the industries if all wage earners had been continuously employed throughout the year. The quotient obtained by dividing the amount of wages by the average number of wage earners cannot, therefore, be accepted as representing the average wage received by full-time wage earners.

[b] Profits and losses cannot be calculated from the Census figures because no data are collected for certain expense items, such as interest, rent, depreciation, taxes, insurance, and advertising.

[c] The aggregates for cost of materials and value of products include large amounts of duplication due to the use of the products of some industries as materials by others. For the United States as a whole, this duplication amounts to about one-third of the gross value of products.

[d] United States totals, geographical totals, and state totals do not include items for those cities which could not be shown separately because of disclosing approximations of data for individual establishments. In calculating "Value of Products per Wage Earner" for the United States total, geographical division totals, and state totals, only those cities for which full information could be shown were included.

[e] Less than one-tenth of one per cent.

[f] Withheld to avoid disclosing approximations of data for individual establishments.

Source: Figures giving number of establishments, average number of wage earners, wages, cost of materials, fuel and power, value added by manufacture, and value of products were specially compiled by the Bureau of the Census from original schedules of the Census of Manufactures, 1935.

TABLE 3

LOCATION OF MANUFACTURING INDUSTRIES BY STATE AND COUNTY AND TYPE OF INDUSTRY, 1935

MASSACHUSETTS

Industry	Grand Total	Barnstable	Berkshire	Bristol	Dukes	Essex	Franklin	Hampden	Hampshire	Middlesex	Nantucket	Norfolk	Plymouth	Suffolk	Worcester
Group 1: Food and kindred products	1,821	9	49	183	...	225	18	149	24	372	1	69	60	467	195
Group 2: Textiles and their products	1,235	1	22	160	...	63	3	55	12	165	...	71	17	495	171
Artificial leather; oilcloth	10	..	..	4	...	...	..	1	..	1	..	2	...	...	2
Asphalted-felt-base floor covering; linoleum	1	..	..	...	...	...	..	...	..	...	..	1			
Carpets and rugs	16	..	..	1	...	1	..	2	..	4	..	2	...	2	4
Cordage and twine; jute goods; linen goods	17	..	..	5	...	1	..	1	..	5	..	..	1	2	2
Cotton manufactures	131	..	4	57	...	6	1	9	2	15	..	8	4	7	18
Dyeing and finishing cotton, rayon, and silk	43	..	4	12	...	3	..	3	2	4	..	6	...	3	6
Embroideries; trimmings (not made in textile mills); stamped art goods	25	..	..	...	...	2	..	...	..	1	..	..	...	21	1
Fabricated textile products other than wearing apparel and house furnishings	35	..	..	2	...	3	..	2	..	4	..	2	1	17	4
Felt goods, except woven felts	10	..	..	...	...	1	..	...	1	5	..	2	...	...	1
Hats, except cloth hats and millinery	13	..	..	8	...	2	..	...	..	...	..	..	..	1	2
House furnishings	68	1	..	10	...	2	..	...	..	14	..	.	...	38	3
Knit goods	83	.	1	2	...	2	..	8	3	24	..	20	2	13	8
Lace goods	1	..	..	1											
Men's cotton collars, nightwear, shirts, and work clothing	37	..	..	7	...	4	..	1	..	3	..	..	...	16	6

Men's furnishing goods	43	..	..	2	...	..	..	1	..	3	.		...	32	5
Men's, youths', and boys' clothing not elsewhere classified	172	..	..	12	...	5	1	3	..	11	..	5	2	123	10
Miscellaneous apparel and allied products	7	..	..	...	...	...	..	...	..	1	..	..	...	2	4
Rayon manufactures	24	..	1	8	...	1	..	2	2	4	..	..	...	2	4
Silk manufactures	11	..	1	5	...	...	1	3	..	1					
Waste and related products	60	..	1	9	...	6	..	1	..	14	..	9	...	8	12
Women's, misses', and children's apparel not elsewhere classified	291	..	2	13	...	4	..	11	..	25	..	2	3	204	27
Wool and hair manufactures	137	..	8	2	..	20	..	7	2	26	..	12	4	4	52
Group 3: Forest products	520	1	14	25	...	38	19	23	15	109	..	11	21	133	111
Group 4: Paper and allied products	272	..	17	17	...	13	8	58	9	52	..	10	4	46	38
Group 5: Printing, publishing, and allied industries	1,043	5	20	46	1	66	9	93	10	161	1	54	31	456	90
Group 6: Chemicals and allied products	346	1	1	17	...	53	2	24	2	97	..	14	20	94	21
Group 7: Products of petroleum and coal	39	..	2	4	...	5	1	4	2	8	1	1	1	2	8
Group 8: Rubber products	59	..	..	3	...	7	..	2	1	16	..	10	5	11	4
Group 9: Leather and its manufactures	763	..	6	16	...	361	3	9	2	91	..	20	107	90	58
Group 10: Stone, clay, and glass products	218	..	7	12	...	13	2	15	2	51	..	61	5	36	14
Group 11: Iron and steel and their products, not including machinery	412	1	2	26	...	35	9	41	7	84	..	11	20	93	83
Group 12: Nonferrous metals and their products	328	..	1	106	...	12	2	17	2	55	..	8	4	88	33
Group 13: Machinery, not including transportation equipment	660	..	13	68	...	76	13	52	7	115	..	30	24	133	129
Group 14: Transportation equipment, air, land, and water	77	2	..	7	1	19	..	5	..	13	..	1	2	12	15
Group 15: Railroad repair shops	20	..	1	1	...	1	1	3	..	5	..	..	1	5	2
Group 16: Miscellaneous industries	503	.	6	36	...	38	5	45	5	93	..	20	13	165	77

SOME NOTES ON FASHION

Matters of style and fashion change are complex and but little understood. These notes present some of the definitions and theories which have been formulated, but they manifestly fail to explain many of the observed phenomena. By and large, merchandising executives, both in manufacturing and in retail establishments, still operate largely on a "hunch" basis in dealing with fashion problems.

Paul H. Nystrom defines *style* as "a characteristic or distinctive mode or method of expression, presentation or conception in the field of art."[1] Thus a style is a more or less permanent rather than a temporary phenomenon. It may or may not be a fashion at any given time. When a style is generally accepted and used by the people, it becomes a fashion. Thus Queen Anne is a style of furniture today just as it was in 1715. Now, however, it does not happen to be the fashion because it is no longer in general everyday use. As Dr. Nystrom points out, "A fashion is always based on some particular style. But not every style is a fashion. A fashion is a fact of social psychology. . . . A style does not become a fashion until it gains some popular use, and it remains a fashion only so long as it is so accepted."[2]

A fad, as Dr. Nystrom defines it, is "a miniature fashion, usually running for a shorter time and usually applying to some unimportant matter or detail in style of apparel, home furnishings, or other articles of use in which the quality of art is present and important."[3] A fad is usually based on novelty and is ordinarily of comparatively short duration.

Paris, Hollywood, the stylist, the manufacturer, the retailer—each of these has been called the cause of fashion change. Actually all that any one of them can do is create or offer for sale certain styles. None of them can be said to create fashion. Only consumer acceptance can make any style into a fashion. Since fashion depends on consumer acceptance of an idea and since people do not react simultaneously or identically to an idea, fashion change is evolutionary. Fashions are orderly growths which rise from imitation. Thus any fashion has its beginning when only a few people are influenced by it, its culmination when the masses follow it, and its decline when it is gradually abandoned by more and more of its followers.

Of this so-called fashion cycle Dr. Nystrom says: "By this term is meant the rise, culmination and decline of popular acceptance of a style. The popular use of the term unfortunately may be both confusing and misleading. Cycle literally means circle and as applied to fashion suggests starting with some

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Source: Adapted from Malcolm P. McNair, Edmund P. Learned, and Stanley F. Teele, *Problems in Merchandise Distribution* (New York, McGraw-Hill, 1942), pp. 61–68. Reprinted by permission.

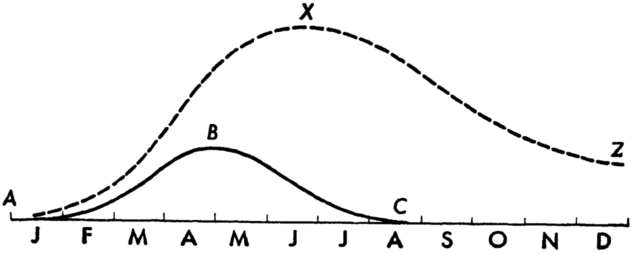
[1] *Economics of Fashion* (New York, Ronald, 1928), p. 3.

[2] *Fashion Merchandising* (New York, Ronald, 1928), p. 33.

[3] *Ibid.*, p. 34.

style, moving away from it and finally coming back to the same style again. Nothing like this is meant by the term 'fashion cycle' here. . . . The fashion cycle is simply the forward wavelike movement completed and involves no necessary repetition of the style." [1]

Most commonly the fashion cycle is represented by a simple curve *ABC* (as shown below), on which *A* is the point of inception, *B* the point of greatest popularity, and *C* the point of abandonment. On the horizontal axis are measured time intervals; on the vertical axis, the number of people purchasing or using the style.



If *ABC* represents consumer purchase of a fashion, consumer use will follow a different curve, *AXZ*. This point is of importance, particularly to the buyer of fashion merchandise. When the fashion is in greatest use (*X*), consumer buying has already declined and store stocks are being cleared rather than replenished.

A fashion commonly tends to follow a regular curve from inception to popularity and so to decline. Various theories regarding this regular movement of fashion have been formulated with reference to the manufacturer, to consumer types and buying motives, to geographical location, and to types of stores and store policy. Exhibit 1 presents some of the more important of these theories in compact form.

A theory of fashion in manufacturing has been formulated by Paul T. Cherington.[2] According to this theory, in the period of inception of a fashion, the manufacturer concentrates on creation or initiation of a style and its adaptation to general use. As the fashion progresses toward popularity, it is imitated by other manufacturers and produced on a somewhat larger scale. Before the peak of popularity is reached, mass production begins. Just before decline of the fashion sets in, its manufacture is abandoned.

John E. Alcott, in lecturing on art in industry, has represented the movement of fashion by a five-rung ladder. The top rung he calls "high style" and suggests that at this point the fashion is adopted only by style leaders. On the second rung, first imitators, or runners-up of the style leaders, begin to purchase. On the other rungs, the white collar masses, the necessity group, and finally the subsistence group gradually adopt the style. Since people tend to imitate their leaders, fashion always moves down this ladder, never up.

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[1] *Economics of Fashion*, p. 18.

[2] "Some Commercial Aspects of Styles and Fashions in the Clothing and Textile Industries," *Harvard Business Review*, Vol. II, No. 4 (July, 1924), pp. 421–433.

Melvin T. Copeland's theories of fashion movement, somewhat more widely known, proceed along similar lines.[1] Interpreting fashion in terms of the consumer and his buying motives, Dr. Copeland asserts that fashion begins among style leaders of high income, who buy through a desire to be distinctive in what they wear, use, or do. "The buying motive of distinctiveness," he declares, "arises from a desire to manifest individuality in judgment or taste, or to display leadership in personal appearance." It is the motive underlying a woman's purchase of a Paris gown—the desire to be different and to be first. "A retail merchant," Dr. Copeland continues, "with a store on Fifth Avenue or Michigan Boulevard, who arranges his window displays with 'exclusive' artistic taste and without display of price tags, consistently caters to the buying motive of distinctiveness. He shuns price comparisons and avoids suggestion of emulation." This retailer operates a high-grade specialty shop [2] either as a unit store or as a specialty department in a department store and advertises his merchandise as "distinctive" and "out of the ordinary."

EXHIBIT I

SOME THEORIES OF FASHION MOVEMENT

Fashion Stage	Manufacturer (Cherington)	Consumer Types (Alcott)	Consumer Motives (Copeland)	Geographical	Type of Store (Copeland)	Store Policy (Creighton)
1. Inception	1. Creation 2. Adaptation	1. Style leaders 2. Runners-up	1. Desire for distinctiveness	1. Paris, Hollywood, Fifth Avenue 2. New York and other big cities	1. Specialty shop (high-grade)	1. Style alertness
2. Popularity	3. Popularization (imitation, reproduction) 4. Mass production	3. White collar masses	2. Emulation	3. Big city department stores, small town specialty stores	2. Specialty shop (medium-grade) and department store (high-grade)	2. Mass merchandising of complete stocks of style in vogue
3. Decline	5. Decline 6. Abandonment	4. Necessity group 5. Subsistence group	3. Economical emulation	4. City basements, small town department stores, and rural districts	3. Department store (low-grade)	3. Special sales promotion 4. Clearance—close-out

If the style gains popularity, Dr. Copeland maintains, the so-called white collar masses adopt it through the emulation motive. This increased demand brings the style within the scope of the high-grade department store and of the specialty shop which reaches out for a large volume of sales.[1] The consumer who purchases through the emulation motive is anxious to equal or rival her associates in display. She wants to "keep up with the Joneses." She does not wish to be behind the fashion in her particular social group; yet she does not have the initiative, judgment, and social influence which might lead her to attempt to set a new fashion. She responds to advertising which stresses such things as "silk, the accepted fabric of elegance," "the modern woman's favorite car," or "the soap all discriminating women ask for."

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[1] *Principles of Merchandising* (Chicago, Shaw, 1924), pp. 163–167.

[2] *Ibid.*, pp. 71, 104.

As the style gains still wider acceptance, it is properly carried by lower grade department stores, where lower income groups purchase it at the prices made possible by mass production. The motive of these groups Dr. Copeland terms "economical emulation." He says, "The appeal to emulation ordinarily does not stress cost or economy. At first thought, furthermore, cheapness seems inconsistent with emulation, for the latter frequently operates to prove, at least nominally, that the consumer can afford to 'keep up' with her acquaintances, that she does not find it necessary to economize more than they do. . . ."[2] As a style becomes successful, however, it is produced in cheaper materials in large quantities and sold at low prices. At this point, according to Dr. Copeland, the motive of economical emulation enters. The motive of economical emulation is characteristic of the late stages of the style cycle and in fact accelerates the rate of style obsolescence. Once a style is sold at very low prices and in large quantities, it no longer appeals to consumers impelled by the motive of distinctiveness.

In summarizing his theory of buying motives, Dr. Copeland declares, "Distinctiveness, emulation, and economical emulation mark three distinct stages in the style cycle. A manufacturer or merchant . . . finds it advantageous to decide in which stage of the style cycle he will operate and then to coordinate his merchandising plans accordingly. The determination of the grade of goods to be offered, the selection of the buying motive to which to appeal, and the choice of the type of customers at which to aim are interdependent decisions from the merchandising standpoint."[3]

Another view, in several respects different from Dr. Copeland's theory, outlines buying motives and behavior with reference to fashion change as follows:

Motive	Behavior
Desire for change Desire for distinctiveness Desire for notoriety	Innovation
Desire for social approbation	Imitation
Desire to go with the crowd	Conformity
Fear of being conspicuous	Acquiescence

In contrast to Dr. Copeland's somewhat aristocratic theory of fashion, this view maintains that a vogue may be initiated by chorus girls, motion picture stars, or shop girls, as well as by the socially elite. Innovation requires adequate purchasing power and a desire for distinctiveness, change, or notoriety; it requires also a sort of social daring. Wherever these are present—in whatever social, cultural, or income group—leaders of the fashion procession may be found. Once the fashion parade has started and the leaders are well in front, a number of spectators promptly fall into line. Thus through desire for social approbation these people imitate styles which they were not courageous enough to introduce. So impetus is added to the fashion movement. When adoption of the style has become fairly general—when the procession has achieved substantial proportions—desire to "go with the crowd" impels the great mass of consumers to conform. Still, however, there are a few ultra-conservatives reluctant to adopt anything new, loath to change their accustomed habits in any detail. Eventually they acquiesce in the new style, but only to avoid being conspicuous.

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[1] *Ibid.*, p. 88.
[2] *Ibid.*, p. 166.
[3] *Ibid.*, p. 167.

The spread of fashion acceptance from one community to another and from one social group to another within a community is described by Dr. Nystrom in his *Economics of Fashion* (page 36). Fashion, particularly in apparel, he says, commonly begins in Paris, in Hollywood, or on Fifth Avenue. As the movement gains force, the style becomes fashionable in New York and other big cities, first in specialty and then in department stores. Some time later, it appears in small-town stores and in rural districts. Although modern means of transportation, the radio, the popularity of motion pictures, the wide circulation of newspapers and periodicals have clearly lessened the so-called geographical lag in fashion, there is still a tendency for fashion to move from big cities to small . . . and from resorts to industrial communities. According to Dr. Nystrom, the sweep of fashion across the country is now very rapid; the spread of a fashion within a community, however, from those who are the first to take it up to those who are the last to adopt it, while more rapid today than in the past, is still comparatively slow. Cities and localities differ from one another, of course, so that fashions do not always spread throughout the country; and if they are countrywide, they do not necessarily spread at the same speed. A fashion readily accepted in New York might not achieve the same acceptance simultaneously in other cities.

A theory of store policy with respect to fashion merchandise is enunciated by Gordon K. Creighton. It is his view that the merchandising operations of a store fall into four distinct phases, as follows:

1. The style-alertness phase: This phase is predominant during the style inception period of early season, but it is never completely absent. This phase also includes the merchandising of high-taste merchandise at all times and in all income classes to which the store addresses its appeal. The keynotes of this phase are individuality, taste, new and significant styles.
2. The fashion-completeness phase: This is the period of mass merchandising of complete stocks of the styles which have proved acceptable to the public and which have become the fashions. The keynote appeal of this phase is completeness of stock on the wanted things, the fashions.
3. Special-sales phase: This phase covers the merchandising of special promotional purchases and sales on the basis of primary market opportunities. The keynote of this phase is value-price.

> 4. Close-outs and clearances of all remainders: The keynote of this phase is also value-price, but with selections more restricted and values more sharply accentuated.[1]

As the season proceeds, Mr. Creighton points out, there is a progressive shift in emphasis from one to another of these phases. For stores of different types, however, relative emphasis on the four phases will, of course, vary.

Many styles never progress beyond the first, or inception, stage. They appear in specialty shop windows but, failing to gain wider popularity, die quickly away. Once they have progressed to the popularity stage, however, fashions may be expected to take their normal course through the cycle.

Fashions may be of either long or short duration. Usually they tend to develop more slowly and to persist longer in durable than in nondurable goods. It is undoubtedly true that the increased tempo of modern living has tended to speed up the movement of fashions, so that, even in durable goods, modes succeed one another more quickly than they did. New technical devices accelerating mass production and facilitating effective and cheap reproduction of styles likewise have made the progress of styles from the inception stage to extinction much more rapid. Other contemporary phenomena, such as increased purchasing power, increased leisure, ease of communication, effective sales promotion, and a generally progressive spirit, may speed a particular fashion in its course.[2] In the same way, human customs, habits, and dislike of change, as well as religious or social forces, may retard the speed of a fashion movement.

Just as each fashion goes through a regular period of development, so each series of fashions probably tends to follow a regular curve. Fashions are not isolated movements which have abrupt beginnings and endings because people are creatures of habit and custom, and new ideas are not readily accepted unless they are related to something to which people are already accustomed. Each fashion, therefore, grows out of preceding fashions and merges into those which succeed. That there are only a few basic styles and that each of these dominates for a period of about 30 years and is then followed in a definite order by another basic style is the conclusion of a study, *Recurring Cycles of Fashion, 1760–1937*, by Agnes Brooks Young.[3] Following are several excerpts[4] which briefly summarize the main thesis of the book:

> In summary the thesis of this book is that women's dress fashions comprise three fundamental types which depend on the form and contour of the skirt. These may be designated as the back-fullness type, the tubular type, and the bell-shaped type. These three types may be termed major cycle types, since they dominate fashion for extended periods of time and in regularly recurring sequences. Each one dominates in turn, excluding the other two, over periods of approximately a third of a century. . . .

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[1] Excerpt from address before Sales Promotion Division and Merchandise Managers' Group of the N.R.D.G.A., reported in *Women's Wear Daily*, February 6, 1929. Reprinted by permission.

[2] See Nystrom, *Economics of Fashion*, pp. 24–29.

[3] New York, Harper, 1937.

[4] Pages 18, 21, 27–28, 66–67, 118. Reprinted by permission of the author and the publisher.

If there is in reality a fixed order in the cycles, that phenomenon may be susceptible of a more logical explanation than would at first thought be apparent. In the first place, there are only three basic types of skirt. There is the tubular skirt, which is relatively form fitting, and there are skirts held away from the body on some sort of supporting framework, or its equivalent. These necessarily fall into two classes, and only two—the bell skirt, which may be large or moderate in circumference, and the back-fullness skirt. Much research has failed to devise any other lasting type. A front-fullness skirt is impracticable, and side-fullness styles of the pannier mode have been repeatedly introduced as variants in back-fullness and even in bell cycles, but they have never survived long enough to establish themselves in cycles of their own. Probably it is really true that there are only three distinctively fundamental types of skirts and that there cannot be any more. If so, the reason for the unchanging order of their reappearance in the dress cycles becomes a relatively simple matter to explain.

This reason is to be found in that curious trait of human nature which leads us to look back at almost all relatively recent styles as rather amusingly distasteful. We think of Model T Fords as being funny, and of ten-year-old radios as looking grotesque, and of rocking chairs as fit only to be relegated to attics. This dislike of recent former fashions usually extends back in the case of dress to include all the fashions that we can individually remember. We should not seriously think of reviving any of them, and so they are always subject to a kind of taboo. Moreover, the older women among us who are still of an age to participate actively in fashion retain just as acutely disagreeable impressions of the fashions of their girlhood days and the fashions they remember their mothers wearing as the younger women do of the fashions that prevailed 10 or 15 years ago.

At present, the older women among us retain memories of the back-fullness fashions of their girlhood days, and so the present fashion taboos cover all the earlier forms of the tubular skirts of this cycle, and the back-fullness styles of the previous cycle as well. If we are to change soon to a new cycle, it can only be to a bell cycle, for the other alternative is barred. Probably it is fair to say that at any given time there are two types of fashions that women in general consider ugly and ridiculous. One group consists of the earlier variants of the current cycle, and the other comprises the fashions of the previous cycle. Thus the general antipathy toward remembered fashions explains the unchanging order of sequence in the recurrence of fashion cycles; there are only two choices for a new cycle, and the one of these which is remembered is taboo.

. . . .

The first back-fullness cycle lasted from 1760 through 1795, or 36 years, when it gave way to a tubular cycle, which persisted from 1796 through 1829, or 34 years. That was followed by the bell or so-called hoop-skirt cycle, which continued from 1830 through 1867, or a period of 38 years. Thus, the three cycles brought us through our Civil War period to a time just a little more than one hundred years from the beginning of our first back-fullness cycle in 1760. Then, in 1868 a new back-fullness cycle started, and we recall it as a period when bustles were in use. It lasted through 1899, or for 32 years, and was followed by the tubular cycle which has lasted up to the present time. The earlier tubular cycle began in 1796, or 104 years before this one.

. . . .

Probably fashion change falls into three main classifications: first, the alteration of underlying cycle type; second, the alteration which is made without damage to the cycle type, called here a variant, the kind of adaptation of the fundamental contour comprised in the hobble-skirt and the knee-length skirt; the third might be described as the alteration of details which are not in themselves sufficiently important so that the alteration produces variants but which, as altered, supply the subtle differences by which the initiated can distinguish the new from the old in a given season.

. . . .

Each of the three types, back-fullness, tubular, and bell, lasted for long periods of time, during which its characteristic structure completely dominated fashion. During

> these periods of dominance a regular and steady change occurred annually—and almost it might be said, seasonally—but in such a way as to preserve the dominant form of the type, the change taking place, as it were, within the boundaries of the dominant silhouette. Fashion in modern times has consistently followed this pattern of evolutionary change based on the contour of the skirt.
>
> . . . .
>
> We may well ask what is the compelling force which causes women to abandon a principle of dress which has proven satisfactory for a third of a century and to adopt a previously discarded type. The fact that the tubular contour was discarded after a long trial in the 19th century raises the question whether we also will abandon it in favor of more restricting modes. Our tubular cycle has about fulfilled its normal span of life, and the cycle theory is about to be put to the test. In the next few years we shall know whether we also will discard the form-fitting type, and, following the example of the past, adopt some form of the bell-shaped contour. We shall know whether we are in truth free and emancipated, as the women of the early 1800's thought themselves to be, or whether we shall confirm the mysterious and inflexible law which has controlled fashion for the past two centuries or more.
>
> . . . .
>
> Whether or not the sequence of the recurring types that has remained unchanged in the past will be maintained in the future, no one can tell. We are even now at a time when the tubular cycle should shortly, according to precedent, be replaced by another type. If the old order is maintained, we should in time have bell skirts once more.

Styles usually catch the popular imagination only if they are directly in line with some trend, with some current fact, or with some line of thinking already established. Although retailers and stylists can guide and influence the character and direction of fashion movements, they cannot create them. The successful fashion seems to be that one which is in line with current trends of living and thinking. Outstanding current events, dominating ideals, and dominating social groups often form a base from which fashions may be originated.

But as indicated at the outset, theories about fashion change have not yet developed to a point where they provide a satisfactory basis for management principles. Indeed there is doubt in many quarters whether fashion follows any predictable pattern. In her book *Fashion Is Spinach*[1] Elizabeth Hawes goes to the extreme of condemning fashion entirely:

> . . . I've become convinced that ninety-five per cent of the business of fashion is a useless waste of time and energy as far as the public is concerned. It serves only to ball up the ready-made customers and make their lives miserable. The only useful purpose that changes in fashion can possibly have is to give a little additional gaiety to life. But by the time you've taken off fashion's bright cellophane wrapper, you usually find not only that fashion is no fun at all, but that even the utility of your purchase has been sacrificed.
>
> Fashion is so shrouded in mystery, so far away and so foreign, so complicated, and so boring when you understand its ways, that it has become a complete anachronism in modern life. One good laugh, and the deformed thief would vanish into the past.

On the assumption, however, that theories of fashion can be made to serve management, the following questions are still among those which remain to be answered:

1. Is there any basis of forecasting what particular styles are likely to become fashions; in other words, is the vogue of any particular style purely accidental, or is it possible that observation of fashion phenomena will ultimately give a basis for forecasting which of two styles is more likely to become a fashion?

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[1] New York, Random House, 1938, p. 11. Reprinted by permission.

2. Is the social stratification theory of fashion movement sound, with its implication of definite zones of activity for various grades of stores; or is this an oversimplification of the facts? From a practical aspect, what are the indices which a manufacturer or distributor should watch in determining what fashions to offer and what fashions to discontinue?
3. Is the geographical spread of fashion more rapid than the spread among groups in the community? Has the reduction in geographical lag been sufficient to permit synchronized mass merchandising of fashion goods?
4. Is there a speeding up of the movement of fashions from group to group in a community comparable to the reduction in the geographical lag?
5. Is the speed with which a fashion declines related to the speed with which it was adopted, or does this depend on other factors?

CHANGES IN THE WHOLESALE DRY GOODS BUSINESS

BY J. O. McKINSEY

I. TRENDS IN CONSUMER BUYING HABITS

A. INCREASED INTEREST IN STYLE

The interest in style has increased to an unusual degree during recent years. The consuming public has become style conscious to an almost unbelievable degree. The buyer of every type of commodity insists that it be in harmony with the most recent style change in that particular field. Whether it be hosiery for the infant or house slippers for the aged, the product must be in accordance with the dictates of fashion.

. . . .

Through motion pictures, periodicals, and the radio, the public is educated continuously with reference to new product styles. The consumer sees the latest style worn by her favorite actresses, hears of the latest products in the persuasive voice of the radio announcer, and sees the latest creations of art in the magazines and newspapers which come to her easy chair.

In 1922, weekly motion-picture attendance was approximately 40,000,000. In 1930, more than 100,000,000 people attended motion-picture theaters weekly. The first official radio broadcast was in 1920. By 1923 there were approximately 1,500,000 radios, and it is estimated that there are now approximately 20,000,000 radios in use, or nearly one for every family in the country. Periodical circulation has increased rapidly since 1920. The circulation of the six leading women's magazines, each of which features style news, increased from 7,278,000 in 1920 to 13,668,000 in 1934.

Within a few weeks the entire population of the country has an opportunity to see the same styles pictured on the screen, in the magazines and newspapers,

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Source: Adapted from a 45-page brochure, *Now We Are Ready—Let's Go,* issued by J. O. McKinsey, Chairman of the Board of Marshall Field & Company, to the employees of the company in February, 1946. Reprinted by permission.

and to hear them discussed over the radio. More recently style photographs have been flashed from country to country and from one part of the nation to another by means of radio and telegraph. The consumer has become more and more style conscious because of constant exposure to style through these means.

. . . .

Production facilities in many lines of industry were greatly expanded during World War [I]. This was particularly true in the fields producing staple merchandise. After the depression of 1920 and 1921, many of these manufacturers found they had excess production capacity.

A few of them seized upon the increased tempo of living and the new habits and modes to develop merchandise which appealed to these new desires. New styles enabled them to render obsolete, merchandise which had previously been fashionable and to create an accelerated demand for their goods. . . .

Thus some industries seized upon the prevailing conditions to foster style and fashion influences as a means for solving some of their problems. The various conditions and developments which we have previously discussed made it possible to make rapid headway with this type of merchandising.

The Major Effects of the Increased Interest in Style Have Been:

It has made seasonal trends less emphatic. Prior to the war most products which were used throughout the year, such as clothing, were subject to two style changes a year—spring and autumn. During recent years because of the increased interest in style, the style of many products is changed almost month to month. It is rare in the case of fashion articles that the line established at the beginning of the season can be continued throughout the season without change. The manufacturer of such merchandise must be in close contact with the consumer demand so that he can adjust his product quickly to meet this demand. The retailer of style merchandise desires to be in a position where he can present his needs quickly to the producer.

Styles have become less exclusive. A quarter of a century ago a style presented to the public in one part of the country might not become well known to the buying public in another part of the country for six months to one year. For example, the styles in New York did not usually become popular in the Middle West until the next season. Today a woman in a small town in the Middle West becomes quickly aware of the styles popular in New York or Hollywood simply by attending the neighborhood movie. This condition leads to all classes of people becoming familiar with style trends and results, in turn, in style parity. The manufacturer of lower priced products will imitate the style of the higher priced products so as to cater to the style consciousness of those in the lower income brackets. These conditions decrease the exclusiveness of any particular style and in turn require the creation of additional styles to satisfy those who do not desire to use that which is being used by all classes of the consuming trade.

It leads the consumer to seek trade centers where she can have a greater choice of styles, and it leads the retailer to seek style centers so he may have closer contact with style creators. The housewife is not content to view the styles in the small general store located in the rural village. She desires to see the styles in a number of stores in the trade center 50 miles away. The retailer in the trade center in order to cater to the desires of the housewife prefers to deal directly with the manufacturer who is creating styles.

B. INCREASED DEMAND FOR LOWER PRICES

There is a continuing demand for lower prices on the part of the consumer. The effectiveness of this demand depends upon the stage of the business cycle and the conditions affecting each specific product.

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The major effects of the demand for lower prices have been the following:

There has been an increased tendency for the consumer to shop to secure lower prices, and this has led him to go to trading centers where such shopping is possible.

It has led the consumer to patronize stores which purchase in sufficiently large volume to enable them to obtain price concessions from the manufacturer, which in turn they can pass on to the consumer.

C. INCREASED TENDENCY TO SHOP IN TRADING CENTERS[1]

There is substantial evidence to show that there has been an increasing tendency for consumers to buy in the larger trading centers. Studies based on the 1930 Census show that 93 metropolitan markets, containing approximately 47% of the country's population, sell nearly 62% of the total merchandise sold at retail. The significance of these metropolitan markets in the sale of various types of merchandise is shown by the following data:

IMPORTANCE OF 93 METROPOLITAN MARKETS IN THE UNITED STATES

(1933 data)

	Percentage of Total Retail Stores	Percentage of Total Retail Sales
Grocery	55.8	61.9
Drug	53.4	60.8
Shoe	62.9	75.2
Filling stations	38.3	48.7
Department—general merchandise variety	40.7	65.6
Total retail	51.2	61.1

These data show that 40.7% of the merchandising stores of the United States are located in these 93 metropolitan markets, but that these stores sell 65.6% of the merchandise sold at retail.

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[1] It is somewhat difficult to define what constitutes a trading center. In the South and Northwest it may mean a town of 2,500 population or more. In the eastern states it usually means a town of 5,000 or more. In some sections there are few towns of less than 10,000 population which can be regarded as such centers.

The Census of Distribution for 1929 shows that retail sales in towns of 10,000 and less aggregated nearly $15,000,000,000, or approximately 31% of total sales. Approximately 20% of these sales, however, were made in towns which lie within the boundaries of the 93 metropolitan markets. This means that approximately $12,000,000,000, or only 25% of total retail sales in 1929, were made in towns of 10,000 or less, which were not part of metropolitan markets. These data show the extreme importance of the larger marketing centers.

A recent survey shows that the county-seat type of town of 10,000 population or more is drawing an increasing proportion of the total business outside of the metropolitan districts. Even the county-seat type of town is losing a considerable amount of its former business to the cities of 25,000 to 75,000 population.

Studies indicate a continuation of the trend to buy in larger centers. The major reasons for this trend are the following:

1. The influence of the conditions we have previously discussed, namely:
a. Increased interest in style
b. Increased demand for lower prices
2. Improved transportation which makes it easier to reach the trading center
3. The shift in population. Since 1900 the increase in urban population has been as follows:

PERCENTAGE OF POPULATION IN CITIES OF 8,000 OR MORE

1900	32.9
1910	38.7
1920	43.8
1930	49.1

With the greater number of people living in cities, it is natural that the amount of purchasing done in these centers would increase.

The major effects of the increasing trend to buy in trading centers are the following:

1. The shifting of trade from the village store to the trading center. Thousands of small dry-goods stores in the small villages have gone out of business during the past quarter of a century. Many of those now remaining are in poor financial condition and handle only a limited line of low-grade merchandise.

2. The shift of trade from the small county-seat town to the larger cities.

3. The development of larger retail units, such as department stores, and of the merchandising chains.

4. Greater division of activities in the retail units and the appointment of special buyers for different commodities.

D. INCREASED BUYING FROM CHAINS

The growth of the chain store has been one of the outstanding developments in the merchandising field during the past quarter of a century. Chains handling all types of merchandise have experienced rapid growth. It is estimated that in 1914 there were approximately 2,000 parent companies operating three or more units, with a total of approximately 23,893 units, and sales of not over

$1,000,000,000. The 1930 Census showed approximately 7,000 companies with 159,826 store units which had total sales in 1929 of nearly $11,000,000,000. The growth of these chains in the merchandise and apparel industry has been comparable with that of the chain store industry as a whole. The reasons for the growing retail sales in trading centers have been stated in our previous discussion. This, in turn, has tended to produce an increase in buying from the chains.

The major effects of the increasing trend to buy from chains are the following: It has drawn more people into trading centers; . . . it has increased the tendency for goods to flow directly from the manufacturer to the retailer.

II. Trends in Retail Buying Methods

In the previous chapter, we saw an increasing tendency for the consumer to purchase in trading centers and to purchase from the larger retail units and chain stores in these centers.

As a consequence of this tendency, the small retailer has decreased in importance in the sale of quality merchandise to the consumer. Thousands of these small retailers have ceased to operate, and those remaining handle primarily low-priced staple merchandise which they sell in limited quantities and buy in very small units. Their needs are supplied in large part by the local jobber. These retailers are consequently of little significance to the national jobber.

In our present consideration of retail buying methods, therefore, we are concerned only with the retail units in trading centers and in metropolitan markets. Furthermore, except for insignificant purchases, the large retail units obtain their merchandise direct from the manufacturer. The amount purchased from other sources is not of sufficient volume to merit consideration by the national jobber of quality merchandise. The following discussion, therefore, is concerned with the buying methods of retail stores in trading centers and metropolitan markets.

These retail stores buy primarily in the following ways:

1. Direct from manufacturer
2. Through cooperative buying associations
3. Through buying offices
4. From wholesalers

In the following discussion we shall endeavor to determine the extent to which these retail units use each of these methods and the probable trend in the amount purchased from each source.

A. Direct Purchasing from the Manufacturer

Retailers in trading centers and metropolitan markets have increased their purchases direct from the manufacturer to a material degree during the past 25 years. The reasons for this increase are the following:

Retailers believe that the manufacturer will provide them a wider variety and a better choice of style merchandise than the wholesaler. The manufacturer usually specializes in one line of merchandise and seeks to provide a complete line of products. He usually presents to the retailer a more complete line than the jobber who selects from the manufacturer's stock those items which he thinks will sell more readily.

Retailers believe they are more likely to be protected from local competition when they purchase from the manufacturer. The manufacturer will frequently restrict his sales in a town to one retailer if this retailer provides him a satisfactory distribution, whereas the jobber follows the general policy of seeking to secure extensive distribution in each town.

Retailers believe they can secure better service from the manufacturer since he is organized to render specialized service with reference to the product he produces, whereas the jobber selling a wide variety of products to a much wider variety of customers is not so well organized to give specialized service on a specific product.

Retailers believe they can secure merchandise from the manufacturer at a lower price than it can be secured from the wholesaler since this method of buying eliminates some of the expense incurred by the wholesaler.

Retailers in trading centers and metropolitan markets purchase nearly all kinds of merchandise from the manufacturer. The most frequent exceptions to this general rule are the following:

1. **Millinery.** A considerable amount of this product is purchased from specialty jobbers.
2. **Notions.** These products are purchased frequently from general line jobbers.
3. **Toiletries.** These products are purchased frequently from drug jobbers and specialty jobbers.

The extent to which merchandise is purchased direct varies according to territories, size of cities, size of stores, and types of stores. There is more direct buying in the eastern half of the United States than in the territory west of the Mississippi. Direct buying usually increases with the size of the city and with the size of the store. Specialty stores usually buy a larger percentage of their requirements direct than do general stores. The extent of such buying may be summarized as follows:[1]

Even in the smallest towns in all parts of the country a few lines are purchased direct from the manufacturer. In nontrading centers we estimate that approximately 25% of the total purchases are made in this manner.

In towns of from 3,000 to 15,000 population the leading stores on an average buy nearly 50% of their requirements direct.

In towns of from 15,000 to 100,000 population leading stores on an average buy more than 50% of their merchandise direct.

Retailers whose annual sales volume is between $250,000 and $1,000,000 purchase 75% of their requirements direct.

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[1] "Direct buying" as used in this discussion does not include the merchandise purchased through buying associations. It duplicates in some cases the merchandise purchased through buying agents.

Retailers purchasing more than $1,000,000 per year buy on an average 90% of their merchandise direct from the manufacturer.

There is no reason why the amount purchased direct from the manufacturer will decrease in the near future. In fact, an improvement in conditions will likely result in an increase in the amount purchased from this source, since many stores which do not now buy in sufficient quantities to enable them to deal with the manufacturer will be able to do so if their volume of sales increases. Another reason for the continuance of this practice is that it is favored by the manufacturer as well as the retailer. The manufacturer believes that direct buying on the part of the retailer is advantageous to him for the following reasons:

It enables him to keep in close touch with the style demands of the consumer.

It enables him to promote the sale of his products aggressively since he has a sales organization specializing in these specific products.

It enables him to exercise a more effective control over the resale prices of his merchandise.

It enables him to have direct contact with a large number of retailers and gives him better control of his market than if he is distributing through only a few jobbers who may change to other products for a variety of reasons.

B. COOPERATIVE BUYING ASSOCIATIONS

Cooperative buying associations are of various types. They usually consist of independent department stores who have merged their buying efforts. The association usually establishes a central organization in New York City. This organization is often a separately incorporated company which carries on one or more of the following activities:

1. Research
2. Styling
3. Establishment of uniform accounting methods
4. Collection and distribution of operating data
5. Personnel work
6. Central buying

The buying organization usually consists of specialists in each line of merchandise. The specialists perform the following activities:

1. Assist store buyers on their trips to the New York market
2. Buy for the store buyer when he is not in the market
3. Pool the buying orders of several units where large volume can be used to obtain price concessions, discounts, or advertising allowances

It is estimated that the stores which are members of the buying associations have an annual volume of more than one billion dollars. The amount of their total requirements which different stores purchase through these associations varies to a considerable degree. The importance of this method of retail buying is indicated by the following:

There is only a limited number of large department stores which are not associated with some kind of a buying association. In several of the most important metropolitan markets many of the stores doing the largest volume of business are members of buying associations. For example, in Boston, six of the eight largest department and specialty stores are members of these associations. The other two are members of a department store chain.

The buying associations represent stores located in all sections of the country. For the most part, however, their members are confined to cities having a population of 75,000 or more. Stores in the smaller cities utilize the services of buying offices instead of using buying associations.

A recent survey indicated a tendency for the importance of buying associations to increase. Most of the retailers interviewed stated that these associations were useful to them, especially in the purchasing of staple merchandise. Some of the larger retailers expressed dissatisfaction with them in the purchasing of style goods.

C. BUYING OFFICES

The buying offices are companies or individuals who offer the following services to clients on a commercial or fee basis:

1. Research
2. Styling
3. Development of selling plans
4. Central buying which
    - *a.* Assists store buyers on their regular trips to the market
    - *b.* Buys for the store buyer when he is not in the market
    - *c.* Pools the orders of various clients to secure a volume in order to obtain price concessions, discounts, advertising allowances, or exclusive style features

The larger buying offices have specialists in the various lines of merchandise. For example, one buying office has 35 buyers in its ready-to-wear department and an equal number handle various lines of staple merchandise. Most of the large buying offices are located in New York, where they concentrate upon ready-to-wear merchandise. The larger ones, however, perform a similar service in the purchase of staple merchandise. One of the large offices, for example, purchases several million dollars' worth of blankets, towels, sheets, and pillowcases for its clients each year.

There are several hundred buying offices in New York City, and these offices have as clients both large and small stores located in towns of all sizes.

These offices are expanding both in number and in range of activities. There has been a gradual growth in their number during the past 15 years and a very large percentage of all department stores are now represented by buying offices. Even stores of an annual sales volume of $50,000 a year will be represented by buying offices in one or more markets. The significance of these offices is that they provide an additional means of purchasing direct from the manufacturer and, as a consequence, decrease the need for the wholesaler.

The Wholesaler. The development of the buying methods we have discussed has continuously decreased the importance of the wholesaler. It is estimated that the large retailers in trade centers and metropolitan markets purchase an average of 80% of the total merchandise they sell either direct from the manufacturer, through cooperative buying associations, or through buying offices.

. . . The volume purchased by the retailer from the wholesaler has declined rapidly during the past 15 years, as shown by the following table:

Sales by Dry Goods Wholesalers

(Index numbers. Monthly average, 1919 = 100)

1919	100	1927	81
1920	115	1928	78
1921	83	1929	81
1922	83	1930	70
1923	95	1931	63
1924	91	1932	51
1925	91	1933	53
1926	87	1934	56

There appears to be no reason why the proportion of purchases from the wholesaler will increase. In fact, there are indications that the decline will continue.

Moreover, the purchases made from the wholesaler consist largely of the following:

1. Fill-ins
2. Small orders
3. Products purchased at reduced prices for special sales purposes

In other words, the retailer in the trading centers and the metropolitan markets uses the jobber to supply him with the merchandise on which the vendor receives the least profit.

The retailer in his purchases from jobbers is inclined to use the specialty jobber and the local jobber to a very considerable degree. The larger stores prefer the specialty jobber because the buying in these stores is highly specialized and the buyer prefers to deal with the specialty jobber whom he feels to be better qualified in his specific field than the general jobber. The retailer in many cases prefers the local jobber because he feels he can secure better service from him than from the national jobber on the particular type of merchandise he desires to obtain, especially on fill-ins and small orders.

Under these conditions the outlook for the *national* jobber of *quality* merchandise is very unsatisfactory. He can no longer sell on a profitable basis to the merchant in a nontrading-center town, and he can expect to secure only a small percentage of the total requirements of the better class of retailers in trading centers and metropolitan markets. Even that percentage which is available to him is not of the type of merchandise which it is most profitable for him to handle.

III. The Problem of the Wholesaler of Quality Products in the Merchandising Field

A. An Answer to the Problem

The discussions in the two previous chapters showed very definite trends in consumer buying habits and in retail buying methods. Through these, we can now appraise the present condition and outlook for the market in which the *national* jobber of *quality* merchandise endeavors to sell his products. Such an appraisal emphasizes the following conclusions:

1. That there has been a rapidly increasing tendency for the consumer to purchase in the trading center and the metropolitan market.
2. That, as a result of the former, the merchant in the nontrading center has become increasingly less significant as a means of distributing merchandise.
3. That, consequently, a large portion of the former market of the jobber has disappeared. The total purchases of the merchants in nontrading centers are only a small percentage of what they were a half century ago.
4. That the important retail outlets in trade centers and metropolitan markets purchase a large percentage of their requirements direct from the manufacturer or through buying associations or buying agencies. Thus they have become increasingly less important as a market for the jobber. It is estimated that on the average they do not purchase more than 20% of their requirements from the jobber and that a considerable percentage of these purchases consist of fill-ins, small orders, and special-priced merchandise.

1. Position of the Wholesaler [1] in Small-Town Market. The outlook for the wholesaler in the small-town market is not promising for the following reasons:

1. This market has decreased very materially in importance during the past 25 years and is now not a significant factor in the distribution of *quality* merchandise.

This conclusion is substantiated by the records of a representative wholesaler which showed that in a group of towns typical of the small-town market, the number of customers in towns of 3,700 population and less declined 54% between 1921 and 1934.

Indicating concretely what has taken place in this type of town, which is typical of similar experiences in a large number of towns, is the following example:

This town had a population of 2,800 in 1929 and 3,100 in 1930, an increase of approximately 10%, while the population of the country during this period increased 16%. In 1921, there were 14 accounts, sales to which aggregated $36,000. In 1934, there were 5 accounts, sales to which aggregated $13,000. This decrease was due primarily to stores going out of business or becoming such poor credit risks that they could no longer be sold with safety.

2. The products of a national jobber of quality merchandise are not well suited to the needs of most of the small-town markets. The merchants in nontrading centers sell primarily staple merchandise of low quality. Most of them

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[1] "Wholesaler" as here used refers to wholesaler, or jobber, operating nationally.

do not sell style merchandise and do not sell staples of high quality. The typical small-town merchant does his largest business in such lines as overalls, men's work shirts, cotton wash dresses, piece goods, and notions. These lines are predominantly staple in character and low in price.

An analysis of departmental sales of a national jobber showed that the largest volume of his business was secured on staple and low-priced merchandise. Sales in towns of 2,500 and less to representative accounts indicated that the greatest volume of sales was in the following departments: hosiery, men's furnishings, percales and ginghams, cotton wash dresses, underwear, nightwear and lingerie, domestics. These departments offer primarily staple and low-priced merchandise.

In a recent survey small-town merchants gave the following reasons for not buying from national jobbers:

a. Price: Too high
b. Attitude: High credit requirements and autocratic dealing
c. Quality: Too high for the trade
d. Service: Back orders, infrequent calls, slow delivery
e. Style: Behind the market on style goods

A number of these retailers stated they would like to handle *quality* merchandise but that their customers would not pay the prices which they must charge for merchandise of this character.

3. The local jobber is better equipped to serve this market than the national jobber. The local jobber is securing a very substantial portion of the wholesale business in all those localities where competent local jobbers exist. Retailers gave the following reasons for their use of the local jobber:

a. Service. The merchants contended the local jobber provided better service than the national jobber for the following reasons:

1. His salesmen called more frequently.
2. Delivery service was more prompt, due to the proximity of the local jobber's warehouse.
3. The merchant could visit the display rooms often and select the merchandise he desired.
4. The products and operations of the local jobber were adapted to meet local conditions.

b. Volume. Many merchants stated that they were using local jobbers because their volume in dry goods was insufficient to justify the national jobber selling them on a reasonable basis.

c. Price. In many cases, the small-town merchant believed the local jobber operated more economically than the national jobber and as a consequence gave him goods at lower prices. They also felt that savings could be made in shipping costs in buying small orders from the local jobber.

d. Credit. The local jobber is better acquainted with the trade than the national jobber and as a consequence will frequently extend credit to customers to whom credit is refused by the national jobber. This is a more important reason for using the local jobber than the merchant will admit since he usually does not desire to state his financial problem.

e. Local Pride. Some small-town merchants stated they favored the local jobber because they wished to aid the business houses in their territory.

From the foregoing it is apparent that the national jobber does not occupy a satisfactory position in the small-town market and that the prospects for improving this condition are not promising.

2. Position of the Wholesaler in Trading Centers and the Metropolitan Markets. The purchases from the jobber by the better grade of accounts in this market have declined rapidly during the past quarter of a century. The total purchases from this source will not average more than 20% of the total requirements of these accounts. The wholesaler in seeking to sell these accounts as a jobber, therefore, is competing for 20% of the market instead of the 80% which is supplied from other sources.

The purchases made from the jobber by these accounts are of such a type that most of them are not profitable for a national jobber of quality merchandise to handle. These accounts use the jobber primarily to secure the following:

1. Fill-ins
2. Goods ordered in small quantities
3. Goods purchased at low prices for special sales

These accounts, to a very large degree, prefer to buy from specialty jobbers and local jobbers rather than from the general national jobber. They prefer to buy from the specialty jobber because they believe these have a wider variety of better styled merchandise than the general jobber. They also believe that the representatives of these companies are better informed on the products they sell. Many of these accounts prefer to buy from the local jobber those items which they do not purchase from the specialty jobber primarily because of the better service they secure from the local jobber in the way of quick deliveries and low transportation costs on small units.

Because of these conditions the ability of the wholesaler, or national jobber, to profitably serve this market is definitely limited. Furthermore, a company seeking to operate in the dual capacity of a jobber and manufacturer is handicapped in the sale of its products. Buyers in the larger stores are prone to look upon such a company simply as a jobber and as a result of this prejudice give less consideration to its products than to those of other manufacturers.

3. Summary of Conclusions on Place of the Wholesaler in the Merchandising Field.

1. That the wholesaler, or national jobber, of quality merchandise, as such term is here used, does not occupy a satisfactory position in the small market for the following reasons:

a. This market has decreased to a very material degree during the past 25 years, and as a consequence he has been forced to meet increasing competition in a declining market.

b. The products of a national jobber of quality merchandise are not well suited to the needs of most of the merchants in the small-town market.

c. The local jobber is better equipped to serve this market than the national jobber.

2. That he does not occupy a satisfactory position as a jobber, as the term is here used, in the trading-center market for the following reasons:

a. The amount which the better grade of retail units in this market purchases from the jobber has declined very rapidly during recent years.

b. The purchases made from the jobber by these accounts are of such a type that most of them are not profitable for a national jobber of quality merchandise to handle.

c. These accounts, to a very large degree, prefer to buy from specialty jobbers and local jobbers rather than from the general national jobber.

3. That a company operating in the dual capacity of a jobber of quality merchandise and as a manufacturer does not occupy a satisfactory position in the trading-center and metropolitan market because many buyers, by reason of their prejudice against such a company as a "jobber," hesitate to purchase its manufactured products.

B. AN ANSWER TO THE PROBLEM AS IT CONCERNS MARSHALL FIELD & COMPANY

The foregoing brings us to a discussion of the Wholesale Division of Marshall Field & Company which operated as a wholesaler, or national jobber, also as a manufacturer and importer. The conclusions drawn in this and the previous chapters applied with particular force to the Wholesale Division.

Under these conditions it was not only desirable but necessary that serious consideration be given to the adoption of the following program which would insure the success of the Wholesale Division in its future operations:

1. That the Wholesale Divisions cease to operate as a "jobber," thereby discontinuing the sale of products which were purchased from other manufacturers. This meant the elimination of the following lines: "hard lines," including jewelry, handbags, toys, hardware, electric accessories, notions, toilet goods, tableware, lamps, clocks, luggage, furniture, linoleums, mattresses, etc. Miscellaneous dry goods, including men's furnishings, women's silk ready-to-wear, batts, comfortables, corsets, women's neckwear, women's beachwear, ribbons, laces, buttons, etc.

2. That henceforth this Division be known as the *Manufacturing Division*, and that it concentrate upon the sale of goods of its own manufacture, conversion, or exclusive importation. This meant the continued production and distribution solely of textiles (in the broad meaning of the word). In order to insure logical and concentrated sales management we have divided the products into the following groups:

a. Cotton and wool blankets and flannels—all types; bedspreads; sheetings and sheets; table linens—plain and fancy; towels and toweling—plain and fancy.

b. Cotton wash goods—woven and printed, sheer and coarse, novelty and plain; rayon and cotton wash goods—same varieties as above; silk piece goods—same varieties as above; woolen piece goods—women's suiting, coatings, dress goods.

c. Woven drapery fabrics—all types; lace curtains and curtain nets; printed drapery fabrics—all types; Wilton rugs and carpets; domestic Oriental rugs.

d. Women's full-fashioned hosiery; children's hosiery; men's, women's and children's knit underwear.

e. Women's and children's woven lingerie and nightwear; women's washable cotton frocks.

f. Domestic and imported gloves for men, women, and children—both fabric and leather; men's, women's, and children's handkerchiefs.

3. That the Manufacturing Division will concentrate on selected customers so that every customer we are servicing with our direct distribution plan will mean that he has qualified within the limits that the survey indicated.

4. That the Manufacturing Division seek aggressively to sell its products in trading centers and metropolitan markets to the following groups of accounts:

a. Large retailers in trading centers and metropolitan markets either independently or through buying associations or offices.

b. Mail order houses, chain organizations, jobbers and others who buy in bulk quantities.

It will be noted that these classes account for approximately 80% of the total retail volume.

These decisions meant numerous changes in organization, in personnel, and in general policies.

It is natural that in an organization as large as Marshall Field & Company such changes, made as they were in a comparatively short time, should have been attended by much comment and speculation. However, the foregoing will explain many of the things which, to those not familiar with the background of the situation nor aware of the aims being sought, may have seemed unnecessary.

For the benefit of those who have not visited our mills we might say a few words about them. Our principal manufacturing activities are located in four towns—Spray, Draper and Leaksville, in North Carolina, and Fieldale, Virginia. These towns are all within a radius of 25 miles of each other, so for practical purposes the mills are contiguous. In this area we own at the present time 19 separate mills, employing approximately 7,500 people. The towns are all located in the foothills of the Blue Ridge mountains, and each community is "southernly" picturesque. The mill workers are a contented group, and are well satisfied with the general living accommodations that we have provided for them. While we own and rent to the workers over 2,000 individual houses in this area, the houses are all sufficiently different in construction and appearance to do away with the sameness and ugliness so often encountered in mill communities.

In the area described in the preceding paragraph, approximately 80% of our manufactured products are produced. Altogether the mills contain approximately 4,000 looms and about 150,000 spindles. In this area are produced all of our blankets, sheets, towels, pillowcases, bedspreads, silk, rayon and wool piece goods, as well as our entire Karastan rug weaving operations, and a part of our hosiery production.

Other mills and factories owned by Marshall Field & Company, Manufacturing Division, are scattered in different parts of the country. We have a large knit underwear mill in Pawtucket, Rhode Island; a hosiery plant in Philadelphia; a Wilton carpet and rug mill in Philadelphia; a men's underwear plant at Roanoke, Virginia; lace curtain mills at Zion, Illinois; a thread mill at Monticello, Indiana; and a men's shirt factory at Manistee, Michigan.

In addition to the above-mentioned plants, our foreign manufacturing activities are quite extensive. Handkerchiefs are made in our plant in Swatow, China, and at Puerto Rico; nightwear and lingerie are manufactured by us in Manila, and gloves are made in several European countries.

Moving toward the new objectives, it is interesting to note the following:

1. Sales, merchandise, and production executives have reviewed the entire merchandising activities of the Manufacturing Division, and a close study has been made of style, quality and price of its various products.
2. A Bureau of Styling and Design is now actively engaged in effecting style improvements in the lines.
3. We are aggressively establishing a sales-promotion department, which is now practically complete.
4. A market research director has been engaged, whose entire time will be spent in studying logical distribution methods for our Manufacturing Division to follow.
5. Pricing policies have been agreed upon which will insure the sale of the products on a competitive basis, emphasis being placed upon the fact that the retailer must be permitted a proper markup.
6. Production equipment has been reviewed with the purpose of improving qualities and lowering costs. There is in prospect the spending of approximately $2,000,000 for the improvement of the Division's manufacturing facilities during 1936, of which between $400,000 and $500,000 has already been appropriated.
7. Sales offices have been set up in the various important New York buying center locations.

In embarking upon the program outlined, Marshall Field & Company sacrifices none of its traditional policies, and the Manufacturing Division takes its rightful place in the field of modern merchandising.

CHECK LIST FOR THE INTRODUCTION OF NEW CONSUMER PRODUCTS

INTRODUCTION

A Practical Working Tool

In general, manufacturers intending to introduce a new consumer product study their production and manufacturing factors carefully. They know what materials they will need, where they can be purchased, and how much they will

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Source: U.S. Bureau of Foreign and Domestic Commerce, Economic Series No. 41 (Washington, D.C., U.S. Government Printing Office, 1946), pp. v–vi, 1–22.

cost; they know whether or not an adequate labor supply is available; and whether their plant is efficiently equipped to handle the product.

But all too frequently they do not know the answers to the scores of questions dealing with markets, distribution, merchandising, and selling which they will have to face in order to make the product successful.

A manufacturer who introduces a new product—no matter how good or how useful it may be—without having clearly thought out the course which he will follow to move that product from his factory into the hands of the ultimate consumer, can find himself in very serious difficulties. His position is like that of the man who built a magnificent boat in his garage, only to discover when it was completed that he could not get it through the doors. A great many excellent consumer products have died in factories because their manufacturers had not figured out in advance how to get the product out of doors—that is, how to *sell* it successfully as well as make it.

This Check List for the Introduction of New Consumer Products is offered as a working tool to the manufacturer *who wants to make sure that he has thought his merchandising and selling problems through* before he launches a new product on its way. This booklet is not a textbook; it is a worksheet. And the manufacturer who calls his major executives together and goes over it, line by line, with his pencil in his hand, will get the greatest possible benefit from it.

The Check List cannot answer all of the marketing and merchandising problems which you may have; but careful analysis of it will be like inspecting your entire marketing procedure with an X-ray machine. When you get through with it, you will know exactly how carefully you have charted your course, and how much more thought or investigation will be required of you before you can be sure that your new product will be launched into the competitive arena with the best possible chance of being successful.

The Check List is divided into six parts:

1. The users of the product
2. Channels of distribution
3. Competition
4. Manufacturer's price policy
5. Selling and promotion
6. Legal and related problems

Each of these six parts contains a brief introduction, followed by a list of specific questions. It is suggested that you read the entire booklet first, and let others in your organization read it also. Then sit down, with responsible executives in your organization, and pencil in hand go through the questions, item by item.

Some of the questions can be answered with figures; some with a "Yes" or a "No"; others with a sentence or two. In still other instances, you may not find it worth while or desirable to put the full answer to the question down; but in all such instances, you will know, after considering the question, whether you really know the answer to that question or not.

Then, when you have completed the detailed checking of questions in the main body of the book, transfer your answers to the Summary Check List at the back. On this Summary Check List you will find three columns: one to indicate that you have a satisfactory answer to the question posed; another to indicate that this question requires additional information before it can be answered; and a third to show that the question is not applicable to your product.

When this Summary Check has been completed, you will have at your fingertips a brief "control sheet" which will show you exactly how well you have equipped your product for its competitive battle in the market place. And you will know exactly what further thought and study you must devote to the problem.

I. THE USERS OF THE PRODUCT

The *easy* way to "define" the market for your product is to say that "Millions of people will want it," or "Every housewife needs something like this," or "Every one of America's 134,000,000 people will be a prospect for this product."

That is the *easy* way to convince yourself that you can create an unlimited demand for what you want to sell. But it is never true!

Every product's potential sales are limited by a number of factors. Some can be sold only to young women; others can be sold only to automobile owners; still others will be bought only in warm climates, and not in cold.

Furthermore, every product's potential is limited by the product itself, by its price, by the use to which it may be put, and by a variety of factors over which the manufacturer himself has no control. To give a very simple example: Most of us consider tooth brushes and tooth pastes as items which are "universally" used. Yet obviously they are not used by some 2 million infants who do not yet have teeth, nor to any significant extent by the several million oldsters who have lost theirs. And, of course, a large part of the remaining population—which has teeth and should take care of them—never buy brushes or paste. And among users of tooth brushes and dentrifrices, usage is by no means evenly distributed. Some groups use two to three times as much of these products each year as do other groups in the population.

There are all kinds of other factors which affect the sale of products—some of them obvious, some of them difficult to determine—but equally vital to the successful marketing of any product.

In many cases even successful products might be much more successful if their marketing problems were in sharper focus. Take the case of a manufacturer of high-class shoes, selling for over $12 a pair. This manufacturer had always assumed that the bulk of his business came from wealthy men and women, since the price of his shoes is considerably higher than the average, and as a result he has always directed the bulk of selling and marketing activity at the "class market."

Yet an analysis of 16,000 retail sales in New York proved conclusively that only a small fraction of his business came from the highest income districts of the city, and that his sales—per capita—were just about as good in the low-income neighborhoods as in the highest income neighborhoods! As a result of this study, he changed his whole approach to the New York market, with satisfactory results.

These brief examples are sufficient to indicate that generalizations about the size, location, or character of the possible market for any product are dangerous, and that the only sound, sensible way to determine the possible market for a product is to test, secure the facts, and consider all of the factors involved.

Fortunately, once you are satisfied that the product is properly designed to meet specific consumer needs, this is usually a fairly simple task, requiring nothing more than a little investigation and some thought. If you will get out your pencil and check off the items on the following list, for instance, you will be able to determine quickly the answers to this vital question:

"Am I *sure* that I know the size, location, and characteristics of the market for my product?"

CHECK LIST I

THE USERS OF THE PRODUCT

1. What types of consumers will use the product? (Are they housewives, school children, farmers, salesmen, mechanics, animals, or what?) ______________________________
   ____
   ____
2. How many potential customers are there? .... __________
3. What factors cut down the size of the total market? (Enter numerical estimates in the provided spaces.)
   - *a.* How many live in sections of the country where they will not use the product? .... __________
   - *b.* How many are in the wrong age group to use the product? ..... __________
   - *c.* How many are likely to be poor prospects because your product is too expensive or too cheap for them? (To what income classes will your product appeal?) .... __________
   - *d.* How many are likely to be out of the market because they already have similar products giving satisfactory service? .... __________
   - *e.* How many live in such a manner that they cannot use the product? (*E.g.*, if you live in an apartment, you are not a good prospect for a lawn mower.) .... __________
   - *f.* How many would not be prospects because of religious or racial reasons? .... __________
   - *g.* Are there any other market-limiting factors peculiar to your product? (List and enter number affected.)
     ______________________________ __________
     ______________________________ __________
     ______________________________ __________
     ______________________________ __________

   Total No. 3 .... __________
4. How many prospects are left for your product? (No. 2 minus No. 3) .... __________
5. Where do the potential customers live?
   - *a.* Are they scattered throughout the country? .... __________
   - *b.* Are they limited to particular sections or States? .... __________
   - *c.* What size community do they live in and what are their buying habits?

    i. Cities, and buy at:
        Neighborhood stores.............................. ________
        Downtown stores.................................. ________
    ii. Small towns...................................... ________
    iii. Farms, and buy:
        In town.. ________
        By mail.. ________
  d. Are there climatic or employment factors in their location that you should investigate? (*E.g.*, is your product designed only for cold climates or for workers in steel mills?)................ ________

6. Will the price of the product meet the requirements of your logical prospects?.. ________
7. Will the price of your product compare favorably with existing products of this kind and with similar products which may be introduced shortly? (See Chapters III and IV.)............... ________
8. What is the present consumption of products of this type?........ ________
9. Is the market for this product likely to change in size during the next 2, 5, or 10 years?
   a. Expand... ________
   b. Contract... ________
   c. No change.. ________
10. How often will consumers buy this product? (Is it a durable goods item which will last several years or something in everyday use which needs replacing every few days or weeks?)
    ____ ________
    ____ ________
11. Will the product sell evenly throughout the year or will the bulk of the sales be concentrated at certain seasons?
    a. Evenly.. ________
    b. Seasonally.. ________
12. What features of the product appeal most to consumers? (Rank in the order of importance.)
    a. Cost of operation................................... ________
    b. Durability.. ________
    c. Ease of repair...................................... ________
    d. Price... ________
    e. Service and maintenance............................. ________
    f. Style... ________
    g. Trade-in value...................................... ________
    h. Other... ________
13. What are consumer prejudices, if any, in regard to:
    a. Cost of operation?________________________________
    b. Durability?_______________________________________
    c. Ease of repair?___________________________________
    d. Price?____
    e. Service and maintenance?__________________________
    f. Style?____
    g. Trade-in value?___________________________________
    h. Other?____
14. Are products of this kind usually bought by consumers:
    a. For cash?... ________
    b. On open account credit?............................. ________
    c. On a time payment plan?............................. ________
    d. On an installed basis?.............................. ________
    e. With the expectation of a service guarantee?........ ________

15. If bought on an installed basis, will:
    a. Cost of installation be included in the price of the product? .... ________
    b. Installation of the product require additional expense for the consumer (*e.g.*, rewiring for an electric range)? .... ________
16. Does your product have any possibilities for industrial use? .... ________
    a. If so, what? ________________________________
    ____
    ____

II. CHANNELS OF DISTRIBUTION

It is no exaggeration to say that the success of almost any consumer product depends to an exceptionally large degree on the efficiency of the distribution system which the manufacturer of that product is able to build.

No product has ever been successful unless it flowed smoothly and profitably from the factory through the various channels of distribution into the hands of the ultimate consumers. And no phase of the introduction of a new consumer product is more important than the establishment of proper and efficient channels through which the goods can flow to the ultimate user.

The distribution system in the United States is so highly developed that any manufacturer has a wide variety of possible methods of getting his goods into consumers' hands. This infinite variety of choices makes his sales problem much more simple, and at the same time more complex. If there were only one or two possible ways in which to distribute the product, it would be a simple matter to decide on which to use; but since there are almost any number of paths and combinations of paths that can be followed, the choice of the right paths becomes a matter of very careful study and intelligent thought.

It is vital to remember, too, that the only reason for a distribution system at all is to *make sales to the final user*, and that, therefore, the system of distribution selected should be the one system or combination of systems which is most likely to accomplish this end with the least difficulty and with the greatest expectation of profit.

Too often manufacturers try to set up their system the way they "think it ought to be," instead of the way it *must* be to make sales, particularly if they have other items in their lines, related or unrelated to the new product. Occasionally, it is possible for a manufacturer with an outstanding product to disregard existing channels and the buying habits of consumers, and yet be successful; but generally *it is much smarter, much more effective, and much quicker to fit distribution as nearly as possible into the existing purchasing habits of consumers and into well-established trade channels.*

Naturally, it is impossible for anyone to tell you the "ideal" method of distributing your product without a close study of the product and all your problems. But if you will actually check through the questions in this section, you will probably gain a much clearer idea of the many things you must know and consider before you come to a final conclusion on this very vital subject.

CHECK LIST II

CHANNELS OF DISTRIBUTION

1. Through what channel or channels are consumers accustomed to buying products of this kind?
   a. From retail stores?.................................... __________
   b. By mail from catalog?.................................... __________
   c. From house-to-house salesmen or demonstrators?............. __________
   d. From service outlets (*e.g.*, plumbers, auto or radio repair shops)? __________
   e. Others (*e.g.*, direct from ads, book clubs, or cooperatives)?..... __________

2. Put this question to yourself and your friends and associates: "If *you* were going to buy a product like this, from what outlets would you prefer to make your purchase?"______________________________

3. If the method by which you expect to get the product into consumers' hands is not the same as the preferences stated above, what is the reason for the difference?
   a. Difficulty in securing dealers?.............................. __________
   b. Does not follow pattern used for other products in the line?.... __________
   c. Requires too much time to secure market coverage?........... __________
   d. Competition too great?.................................... __________
   e. Any other?.. __________

4. Are the reasons indicated in question 3 important enough to justify your decision to market your product in a way that does not coincide with the way consumers prefer to buy products of this kind?...... __________

5. Assuming that you will distribute your product through retailers, what kind of retail stores will sell it (*e.g.*, grocers, department stores, hardware stores, gift shops, or what)?______________________________

6. How much do you know about the operations of this type of retailer?
   a. How many such stores are there?.......................... __________
   b. Where are they located?______________________________
   c. What percent of total sales volume in this field is done by:
      i. Independent stores?................................ __________
      ii. Corporate chains?.................................. __________
      iii. Voluntary chains?................................. __________
      iv. Manufacturer-owned stores?.......................... __________
      v. Consumer cooperatives?.............................. __________
      vi. Others?.. __________
   d. On what basis do your competitors usually sell products of this kind to retailers?
      i. Exclusive franchise?................................ __________
      ii. Selected distribution?.............................. __________
      iii. General distribution?.............................. __________
   e. If on an exclusive basis, do dealers expect to be protected against competition from other retail outlets in their town or neighborhood?... __________

  f. Can you sell your product through both independent and chain stores? .... __________
  g. At what seasons of the year will retailers be most likely to buy your product? ____

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7. What is the best and easiest method of selling to these retailers?
  a. Through established wholesalers or jobbers? .... __________
  b. Through exclusive distributors? .... __________
  c. Through your own factory-controlled sales force? .... __________
  d. Through a combination of the above? .... __________
  e. Others? .... __________

____

8. How many wholesalers, jobbers, or other intermediate distributing organizations are there which can logically handle your product? .... __________
9. What is the best and easiest method of selling to them?
  a. Through salesmen, demonstrators, or technical personnel working out of the factory? .... __________
  b. Through branch offices of the factory? .... __________
  c. Through brokers, sales agents, or others? .... __________

____

  d. Do you know the wholesale trade practices or discounts, allowances, billings, credit, and warehousing which you will have to meet? .... __________
10. If products like yours are usually installed or have a service guarantee, will you conform? .... __________
11. If so, have you arranged for the service and installation through the distributive channels? .... __________

III. COMPETITION

It is obvious, of course, that a major portion of the success or failure you achieve with your product will depend on the competition you meet—its size, extent, and intelligence.

In very rare instances, products have been introduced which have been so revolutionary, so extremely important, or so clearly an improvement over everything previously in existence, that it was possible to say, truly, the product had no competition. One might point to the development of a successful means of making a chocolate coating adhere to ice cream (as in the original Eskimo Pie), or the development of nylon yarn, as typical examples of products which had no competition initially. Yet even in these cases elements of competition soon developed.

The chances of developing a new product which the public needs and wants and which is completely and wholly different from any other product are extremely small, and therefore it can be accepted that your new product will enter a competitive market in which it will have to win the battle for orders against stiff, intelligent competition. It will have to be made better, or cost less, or be sold more aggressively and intelligently—preferably all three—in order to win a profitable share of the market.

Since these things are true, it is apparent that *you must know your competition* and must be able to beat it or meet it in the market place. So, while the questions in this part of the check list are few and simple, it will pay you to ***know*** the answers to them as surely as you know the answers to the other questions in this list.

Check List III

Competition

1. What competition will your product face? (List.)
2. What is the reputation of:
   a. Leading competitive firms?
   b. Leading competitive brands?
3. Are manufacturers likely to enter the field with products similar to yours?
   a. If so, what is their reputation?
4. Can any competitor bring out a seriously competitive item quickly?
5. Will marketing your product cause competitors to give you additional or keener competition on your established products, if any?
6. How does your company stand in relation to competitors in the field to be served by the new product?
   a. Is your name and reputation already established in the minds of consumers and retailers with relation to:
      i. Similar products?
      ii. A general reputation for quality?
      iii. A general reputation for dependability, stability, honesty, and fair dealings?
7. In the light of your own standing or lack of reputation in the market for your new product, is it best to trade on your company name in introducing the product, or would it be easier and more satisfactory to build up a separate name for the product itself?
8. Can your product compete favorably with similar products already on the market?
   a. As to price?
   b. As to quality?
   c. As to style?
   d. As to service?
9. To what degree does nonproduct competition exist for your item (*e.g.*, commercial laundries for washing machines)?

IV. MANUFACTURER'S PRICE POLICY

The soundness of the price policy you establish for your product will be the pivot on which the success of your marketing efforts will turn. For that reason, every step in the establishment of a definite and concrete price policy should be carefully considered.

Certain steps in the establishment of a satisfactory price policy cannot be avoided. For one thing, it is obvious that retail prices *must* be in line with competition for the same quality, service, or styling, and that discounts and allowances must be in line with the established practices in the field. Therefore, a thorough knowledge of trade practices and customs in the field served by the product is a first essential in the establishment of a workable pricing policy.

It is likely that, in attempting to enter a new field, or to enter an old field with a new product, you will find it necessary to set up a schedule of discounts and allowances to wholesalers, retailers, and others which will make it attractive to them to add your line; but it should also be borne in mind that many a manufacturer has foundered on the rocks of a system of distributive discounts which has been so large that it has defeated its own purpose.

Unless resale price maintenance is practiced (and this practice, now possible under the laws of many States, should be carefully investigated), an overgenerous scale of discounts can often lead to price-cutting practices under which it becomes virtually impossible for anyone to make any money on your product. If this occurs, the product becomes a commercial football, with results that can be disastrous.

The three most important items, then, in setting a price policy may be said to be these:

1. Be certain that your scale of prices, discounts, and allowances is, at least, in line with long-standing trade practices.
2. Be certain that discounts and allowances are such that each factor in the distributive system, all the way from factory to retailer, not only can, but *should* make a satisfactory profit.
3. Be certain that a proper relation exists between all of the distributive elements who may handle your product, so that no units or groups in your distributive set-up will have so large a price advantage over other units that it is impossible for some wholesalers or retailers to compete successfully with others.

Incidentally, it is well to bear in mind, when setting up your price policy, that clearly-defined Federal laws prohibit the establishment of any price policy which discriminates between individual buyers. You can, of course, provide larger discounts for larger buyers, give special concessions for merchandising service, etc., but in each case these special discounts and concessions must be available on an equal basis to all buyers who meet the specifications you set up.

You should also remember that a price policy embraces more than prices, discounts, and allowances. It embraces everything that goes into the establishment of a true price, including especially such items as credit and collection policies; whether goods are sold f.o.b. factory or on a delivered basis; consignment policies; policy on returned goods, cancellation of orders, and credit for damaged or unsatisfactory goods.

All of the questions in this particular section of the Check List can be answered with a simple "Yes" or "No." If you have developed a carefully planned, intelligent price policy, the answer to every question will be "Yes." If one or more questions must be answered "No," you will have clear-cut warning that further thought and attention must be given to these particular questions.

Check List IV

Manufacturer's Price Policy

1. Do you know, in general, what your price policy will be on this product? .... __________
2. Have you determined what classes of customers will be entitled to discounts and allowances? .... __________
3. Have you determined the schedule of discounts and allowances to:
    - *a.* Exclusive distributors? .... __________
    - *b.* Wholesalers? .... __________
    - *c.* Retailers? .... __________
    - *d.* Other distributors? .... __________
4. After considering trade customs in the field for your product, have you determined policy with respect to:
    - *a.* Pricing point (*e.g.*, f.o.b. factory; local warehouse; delivered)? .. __________
    - *b.* Credit? .... __________
    - *c.* Credit facilities? .... __________
    - *d.* Collections? .... __________
    - *e.* Returned goods? .... __________
    - *f.* Consignment? .... __________
    - *g.* Order cancellation? .... __________
    - *h.* Damaged or unsatisfactory goods? .... __________
    - *i.* Use of minimum retail prices through price maintenance agreements? .... __________
5. Have you considered insurance and transportation costs as well as costs of manufacture and selling in determining your price? ..... __________

V. THE SALES PROGRAM

Having determined the market for your product, the channels of distribution which you will use, the effects of competition, and the price policies which will govern your operation, it now is possible to outline a sales, advertising, and promotion program which is logically and carefully designed to fit the specific needs of this product.

Too much stress cannot be laid upon the wisdom of tailoring your sales, promotional, and advertising efforts to the particular sales problem and the particular product at hand. It may be that your existing sales and promotional set-up can handle the new product with little or no difficulty; but it may also be true that a greatly changed or an entirely independent sales and promotion program will be required for the new product.

It is impossible to generalize on this subject, and only a careful examination and evaluation of all the important facts will provide the proper answer. But what is all-important is that you have a clear realization of the problems involved, and that every effort be made to make your selling program conform to the needs of the product, rather than attempt to fit this set-up into your existing system, at the expense of destroying its effectiveness.

While sales and promotional problems are very closely related and should be dovetailed carefully, it may add clarity of thought to consider each separately.

A. THE SALES FORCE

In many instances, the addition of a new consumer product may be extremely simple from the standpoint of sales organization. This is particularly true if the new product is sold through the same distributive channels and to the same people as existing products, in which case the new product merely becomes an addition to the line which the salesman normally sells.

In many cases, however, this simple solution of the sales problem is not possible, because the new product is sold to a different group of buyers, to different people in the buyer's organization, or requires a different type of selling and consequently a different type of salesman.

A simple example of this is the development of drug store lines by several manufacturers whose primary business has been concentrated in grocery stores. Even though these two types of stores seem rather closely related in merchandising methods, grocery store product manufacturers usually find it necessary and desirable to set up completely different sales staffs to sell their products through drug stores, since the buying habits of these types of retail outlets are considerably different, the distributive organizations in the field operate differently, and merchandising and promotional activities must be especially geared to the practices in each field.

Similarly, some products require a sales force which is technically trained to deal with distributors, while others may require no such training at all; some staple products which are marketed unchanged year after year may be successfully sold by salesmen who have little contact with the factory, while other products may require constant re-education and re-orientation of salesmen, in order to keep them informed of the advantages of new developments, new models, etc.; some products may permit successful sales operations with the use of a small sales force covering a very large territory, while other products may require a much larger force, working relatively small territories intensively; some products may require personal attention from the manufacturer's salesmen all through the distributive process and perhaps even into the hands of the consumer, while in the case of other products the manufacturer's salesman may be able to complete his work when he makes his initial sale to a wholesaler or jobber.

Similarly, the system of salesmen's compensation should be carefully studied, whether the company already has a sales force or is about to establish one, because the method of compensation which may be perfectly satisfactory for salesmen selling one line of goods may be completely unsatisfactory for salesmen selling a different line of goods.

In general, it should be emphasized again that the manufacturer introducing a consumer product should have adequate knowledge of normal sales processes in the field in which he intends to compete and should not assume, without investigation, that his existing set-up, or one which he "believes" would be correct, will be most satisfactory for the particular product the sales force will be required to sell.

CHECK LIST V

THE SALES PROGRAM

A. The Sales Force

1. If you have other products, can your existing sales set-up handle the new item without harming the sale of the others?............ ________
2. If you already have a sales department selling other products, will any changes or additions be necessary?........................ ________
   - *a.* Will it be necessary to:
     - i. Increase the sales force?.................................. ________
     - ii. Decrease the size of territories?.......................... ________
     - iii. Do both?.. ________
   - *b.* Will it be necessary to set up additional supervision or control in the sales department?.................................. ________
   - *c.* Will it be necessary or advisable to change existing methods of compensating salesmen?.................................. ________
   - *d.* Will the salesmen require special training to sell the new product? ________
   - *e.* If the product is a seasonal seller, will its sales peak coincide with that of others of your products and thus add to your problems, or will it come at a different time and thus fill in the valleys?____
     ____
     ____
     ____
3. If a separate sales force is required:
   - *a.* Will a type of salesman which differs from your present type be needed?.. ________
   - *b.* Will the men require special or technical training?............ ________
   - *c.* Will the entire sales force work out of the home office?....... ________
   - *d.* Do you know how many salesmen will be needed?............ ________
     - i. Have you determined their compensation?................ ________
     - ii. Have you worked out territory assignment and routing through the field?.................................. ________
   - *e.* Have you given special thought to the "missionary" selling they may have to do for introductory purposes?.................. ________

B. ADVERTISING AND SALES PROMOTION

Before any consideration is given to sales-promotion or advertising activities, the management should definitely establish the principle that all decisions on advertising and other sales promotion should be made with the same objective efficiency that applies to the selection of production machinery for the factory.

No matter how enthusiastic the manufacturer may be over the possibilities of his new product, he must never forget that all sales promotion is designed to help sell the product and for no other purpose. Advertising and sales-promotion work, like credit or purchasing, is the work of specialists. Overruling the judgment of a trained sales-promotion executive in order to substitute plans based on individual prejudice or personal desires of other executives can be extremely costly, and in some cases disastrous.

Advertising and sales-promotional activities are largely intangible, but that does not mean that they are not subject to the operation of sound basic principles. Furthermore, all activities along this line must be considered in relation to the whole marketing problem—advertising and sales promotion are not things apart, but are integral parts of the selling mechanism, and must be coordinated carefully with all the other operations of the company.

Your promotion program, like your sales organization, cannot be completely successful if it is developed arbitrarily—it must be logically and carefully designed to fit the specific needs of the product, and to dovetail as perfectly as possible with all your manufacturing, marketing, and selling operations.

Because sales promotion and advertising are largely intangible, it is wise to give the most careful consideration to them, to make sure that their objectives are clearly fixed, that the policies which are set up hew closely to the line of these objectives, and that nothing is done which does not fit logically and efficiently into the entire merchandising operation.

Furthermore, it should be realized that advertising and sales promotion perform no miracles, and that a successful program requires a great deal more than the purchase of a "big name" network radio show or beautiful four-color pages in the leading magazines. Well-conceived and intelligently executed promotion and advertising plans have been of inestimable value in increasing the sale of hundreds of products, but on the other hand, poorly conceived and ill-advised efforts along this line can have the most disastrous effects on a business.

Sales promotion and advertising may be likened to air and artillery support for ground troops. Their function is commonly to "soften up" resistance and to make it easier for the ground troops (that is, the salesmen) to accomplish their objective. Thus sales promotion and advertising must not only be intelligently conceived and executed, but they must be perfectly coordinated with all the other factors in the sales army. They must be aimed at the right targets, they must be big and effective enough and sufficiently sustained to do the job assigned to them, and—perhaps most important of all—they must be used in exactly the right places and at the right time.

Let us consider individually each of these prerequisites of successful promotion. Aiming advertising at the "right target"—i.e., the logical customer—would seem simple enough; yet, to hit the right target is frequently a major problem. One example of this is the case of an important manufacturer of a woman's product, who conducted a very popular and "highly successful" network radio program. That is, the program was highly successful in reaching a wide audience and providing that audience with entertainment. But unfortunately it did not result in many sales because it missed the target. Research showed that most of the prospects for this product were young women of the working-girl type, whereas the radio program got the bulk of its listeners from the ranks of somewhat older, married women. These women enjoyed the program, but had little interest in the product.

Similarly, sales promotion must be large enough and sustained long enough to do the job required of it. Some years ago a manufacturer developed a new household product and decided to test its marketability in a single city. He set up a finely executed and well-coordinated promotion and sales campaign in that city, and with the aid of very attractive introductory offers, succeeded in achieving good distribution and making a satisfactory volume of initial sales. But at the end of 3 months, his repeat sales were negligible, whereupon he discontinued the promotion and sales efforts, and prepared to write the new product off as a failure.

Fortunately, however, he was induced to make a check among housewives who had made initial purchases in the city, to determine why they did not like the product and had not repurchased it. This check quickly demonstrated that those who had purchased the product liked it very much, and that the sole reason for the small volume of repeat business was that the "use cycle" of the product had been miscalculated. There was only occasional use for the product in most homes, and it had not yet been reordered because the original purchase had not been used up. Subsequent introductory campaigns, extended 60 days beyond the 3-month period of the original test, indicated satisfactory repeat business and enabled the manufacturer to establish a successful product firmly in market after market.

The matter of making certain that the effort is expended in exactly the right places and at the right time is equally important. The list of advertising campaigns which have been abysmal failures because they were launched before adequate retail distribution had been secured is an extremely long one. No advertising at all is far better than advertising which is so poorly timed that it induces the prospect to ask for the product in his retail store, only to discover that the retailer does not carry it. In such cases—and there have been hundreds of them—the damage done is almost immeasurable.

It is easily seen, therefore, that intelligent planning for promotion and advertising consists of a lot more than merely appropriating a sum of money to be spent. Yet no one need be overwhelmed by the difficulties and possible pitfalls involved.

There is a simple way to set up an advertising and promotion program, and to determine how much money should be invested in it. That simple way is to start with a definite objective, or a number of definite objectives, and then, like the military commander, assign each part of the "fighting forces" to the task they can do best.

For example: One of your first objectives in connection with your new product is to get it in the hands of a sufficient number of outlets, in other words, to get adequate distribution. If you have worked out the preceding sections of this Check List carefully, you know how many such retailers there are, where they are located, and their size. You also have a pretty good idea of how many of these retailers you will have to sell in order to have adequate retail distribution. You know, too, the extent of your "ground forces" (your own salesmen, and the salesmen of wholesalers and distributors) available to make the sales.

It is now comparatively easy to gage the extent of promotion and advertising support these ground forces will need to do the job most effectively, quickly, and economically. You are then in a position to formulate your promotion and advertising campaign to accomplish this specific objective. You may decide that advertising in the trade papers reaching these retailers, sending out direct mail, exhibiting at trade shows, and similar activities are called for.

Having laid out the plan of campaign, the necessary budget almost sets itself. Instead of picking an arbitrary promotion and advertising budget out of the air, you start at the other end, determining the objective first, then detailing the steps involved, and finally estimating the cost. Of course, you will probably find that the "ideal" campaign will cost more than you are able to spend, and that a compromise must be reached. You must then re-evaluate each item in your list, cut or trim the least important, and finally arrive at a program within your financial means and reasonable from the standpoint of possible returns, but still adequate to perform the specific task or tasks which you want performed.

Operating in this manner, with each step in the promotional and advertising operation given a definite objective, this phase of the company operation becomes as scientific, and as amenable to evaluation of results achieved, as your sales or your production operations.

It must be borne in mind, however, that initial costs—for selling, advertising, and promotion—will probably be extraordinarily high in introducing a new product. For products which have fast turnover and are bought over and over again, it is not unusual for promotion expense during the introductory period to be as high as, or even higher than, the total sales volume. And even in the case of consumer capital goods, which have a long life, the cost of introduction to the consumer market can reasonably be expected to be very high.

How high these costs should be, and how long these extraordinary costs are justified, are a matter for individual determination in each case, but they can be determined, and the potential value of each new user can also be determined. On one product selling for $1, it may be well worth while to spend $2 or more to gain a single new customer; on another $1 product, it may be unprofitable to spend as much as 50 cents to gain acceptance in the introductory period.

One other point should be covered in connection with promotion and advertising, and that is the possible employment and selection of an advertising agency. You may already have an agency, and this agency may be perfectly competent to help you with the new product—or it may not. Whether to employ an agency for the first time, to extend your present agency relationships to the new product, or whether to engage a different agency for it, should be a matter of careful consideration. It should be remembered, however, that advertising and sales promotion are specialized fields requiring specialized talents.

B. Advertising and Sales Promotion

1. Have you an existing advertising and sales-promotion set-up which can handle the new product without harming its efforts on behalf of existing products?.................................. ________
   a. If so, how much additional personnel will be needed?.......... ________
   b. If not, are you planning to set up separate advertising and sales-promotion sections or departments for the new product?....... ________
2. Have you an existing advertising agency connection which will be able to handle the new product?............................ ________
3. Have you decided on the details of the advertising program?...... ________
   a. What advertising and promotional support, if any, will be given locally to:
      i. Distributors?________________
      ____
      ____
      ii. Wholesalers?________________
      ____
      ____
      iii. Retailers?________________
      ____
      ____
   b. Who will bear the costs of this local advertising and promotional support, and in what proportion?________________
   ____
   ____
   ____
   c. How will you control such assistance so as to make certain that it is used most efficiently for the benefit of the product?________
   ____
   ____
   ____
   ____
   d. What approach will you use in advertising your product? (See I–12.)________________
   ____
   ____
   ____
   ____
4. Are you familiar with the general sales-promotion practices followed by distributors in reselling in this field?...................... ________
5. Are you familiar with the sales-promotion and advertising practices of other manufacturers in this field?.......................... ________
6. Have you determined what type and how much sales-promotional assistance you will give to your own salesmen?................. ________
7. Are you planning an organized publicity campaign (as distinguished from advertising) to help make your new product familiar to the public?.. ________
8. Will your promotion and advertising budget be determined on the basis of:
   a. The cost of attaining a definite objective?..................... ________
   b. A certain percentage of estimated sales?................. ________
   c. An arbitrary sum?................................... ________
   d. Some other system?.................................. ________
   ____

VI. LEGAL AND RELATED PROBLEMS

In addition to the many phases of the introduction of a new consumer product which we have already discussed, there are a number of very important questions which the manufacturer must be able to answer satisfactorily before going ahead with a new product. In general, these are problems which should be studied by the company's legal counsel, because they deal primarily with patents and trade-marks, legislation affecting marketing, taxes, etc.

You are probably reasonably familiar with patent and trade-mark legislation, although it will obviously pay you to make certain that you do not infringe on any other manufacturer's rights in this field. But perhaps the most important legal difficulties to avoid are those which have to do with marketing; and these are likely to be less familiar to you, because in so many instances they differ greatly from State to State and even from locality to locality.

In the national field, the principal statutes and regulations by which the marketer in interstate commerce must abide are antitrust laws, including the Robinson-Patman and Miller-Tydings Acts, the Federal Food, Drug, and Cosmetic Act, and the Federal Trade Commission Act. It will pay you well to have your legal counsel examine your product, your labeling and advertising, your sales agreements, price policies, etc., in the light of these statutes, and State Fair Trade and Pure Food Laws.

In the State and local field, laws, ordinances, and regulations which circumscribe the field of operation are too numerous to detail, but mention of a few of them will give you an idea of the possible difficulties which may be encountered unless great care is taken.

Premiums and certain types of contests in connection with the sale of merchandise, while legal in most States, are prohibited in some, and material dealing with such premiums or contests must be kept out of the prohibited States, or must contain a specific disclaimer, saying that the premium or contest offer is not good in such States.

In the case of alcoholic beverages, and a number of other products, State laws vary widely on what may be said and shown in advertising and display material; and in many States, certain types of products, such as drug products, may be sold only in certain types of retail outlets.

A substantial number of cities throughout the country have adopted ordinances circumscribing the activities of house-to-house canvassers, and frequently requiring a license. In other States, restrictive laws have been passed which may tend to cut down or eliminate sales of out-of-State products competing with dominant local industries.

We are all familiar with the fact that health laws, building codes, and sanitary codes are in operation in most, if not all, cities. In many instances, these laws prohibit the use of certain types of products in construction or in homes.

CHECK LIST VI

LEGAL AND RELATED PROBLEMS

1. Is the new product patentable?
2. Is its trade-mark protected?
3. Are all claims to royalties or other indemnities settled?
4. Do royalties limit the market for the product?
5. Is there anything in the product, its labeling or advertising which may cause you to become involved in a possible violation of a Federal, State, or local statute or ordinance?
6. Is the nature of the product such that regulations, trade agreements, etc., may restrict or prohibit its sales in certain areas?
7. Is there anything in your pricing policies, trade practices, or selling set-up which might involve a violation of Federal, State, or local statutes or ordinances?
8. Have local licensing and tax problems been considered?
9. Have you determined how the product should be prepared for shipment?
10. Have you investigated the relative merits of the various freight carriers available for moving your product to the market? (E.g., rates, accessibility, territory served, handling of perishables, time in transit, etc.)
11. Will it be desirable to insure your product while in transit to the market?
12. If so, have you made the necessary arrangements for insurance coverage?
13. Are there any special wartime, and possibly postwar regulations, which affect your product?
14. Are there any labor or union regulations which might affect the manufacture or distribution of your product?
15. Are there other problems, peculiar to your product, that should be considered?

SUMMARY CHECK LIST

When you have completed your consideration of the questions on the check lists closing each of the six preceding chapters, use the following summary check list to record your progress in finding satisfactory answers. When you know the answer to a question or have worked out a satisfactory solution, place a check mark in the first column. If you find that you need additional information before you can arrive at a satisfactory answer, place a check mark in the second column. If the question is not applicable to your product, place a check mark in the third column.

The list will then serve as a guide to the degree to which you have satisfied yourself in surveying the factors which influence the successful introduction of a new consumer product. (Note: The numbering system used is identical with that of the six chapter check lists and it will be noted that, in some instances, intermediary questions have been omitted where another single question adequately summarizes the problem involved.)

	Have Satisfactory Answer	Need More Information	Question Not Applicable
I. The Users of the Product			
1. What types of consumers will use the product?			
4. How many potential prospects are there?....			
5. Where do they live?......................			
6. Will the price of your product meet their requirements?............................			
7. Will your product's price compare with existing products and with similar products which may be introduced?......................			
8. What is the present consumption of products of this type?............................			
9. Is the market likely to expand or contract in the next 2, 5, or 10 years?................			
10. How often will consumers buy the product?..			
11. Will the product sell evenly throughout the year, or seasonally?......................			
12. What features of the product appeal most to consumers?............................			
14. Are the products of this kind usually bought on time payments—an installed basis—with the expectation of service?................			
15. If bought on an installed basis, will the price include cost of installation?...............			
II. Channels of Distribution			
1. Where and how are consumers accustomed to buying products of this kind?.............			
3. If you expect to get your product into consumers' hands in some way other than through the usual channels, are the reasons for this decision valid ones?......................			
5. Assuming that you will distribute your product through retailers, what kind of retail stores will sell it?............................			
6. How much do you know about the operations of this type of retailer?..................			
7. What is the best and easiest method of selling to these retailers?.......................			
8. How many wholesalers, jobbers, etc., are there which can logically handle your product?....			
9. What is the best and easiest method of selling to them?..............................			
10. If products like yours are usually installed or have the expectation of a service guarantee, will you conform?........................			
III. Competition			
1. What competition will your product face?....			
2. What is the reputation of competitive products?..................................			
3. Are manufacturers likely to enter the field with similar products?....................			
4. Can any competitor bring out a seriously competitive item quickly?....................			

	Have Satisfactory Answer	Need More Information	Question Not Applicable
III. Competition (*Continued*)			
5. Will marketing your new product cause competitors to give you additional or keener competition on your regular line?..............			
6. How does your company stand in relation to competitors in the field to be served by the new product?..........................			
7. Will you use your company name on the new product, or will you build up a brand name for it?.................................			
8. Can your product compete favorably on a price basis with similar products already on the market?............................			
IV. Manufacturer's Price Policy			
1. Do you know what your price policy will be?.			
2. Have you determined who will be entitled to discounts and allowances?............. ..			
3. Have you set up a discount and allowance schedule for distributors, wholesalers, retailers, and others?......................			
4. Have you decided on your f.o.b. net pricing point and policies affecting credit, collections, returned goods, consignment, order cancellation, and retail price maintenance?..........			
5. Have you considered insurance and transportation costs in determining your price?......			
V. The Sales Program			
A. The Sales Force			
1. Can your existing sales set-up handle the new product?................................			
2. If so, will changes or additions be necessary?.			
3. If a separate sales force will be required, have you determined how to set it up, how many and what kind of men you will need, how to pay them, etc.?..........................			
B. Advertising and Sales Promotion			
1. Have you an existing promotion and advertising set-up which can handle the new product?			
2. Have you a satisfactory advertising agency connection, or are you planning one for the new product?............................			
3. Have you decided on the details of the advertising program?.........................			
4. Are you familiar with sales promotion practices followed by distributors in this field?....			
5. Are you familiar with sales promotion and advertising practices of competitors?........			
6. Have you determined what type and how much sales promotion assistance you will give your own salesmen?......................			

	Have Satisfactory Answer	Need More Information	Question Not Applicable
B. Advertising and Sales Promotion (*Continued*)			
7. Are you planning an organized publicity campaign (as distinguished from advertising)?			
8. Will your promotion and advertising budget be based on (*a*) cost of attaining a definite objective; (*b*) percentage of estimated sales; (*c*) an arbitrary sum; (*d*) some other system?			
VI. Legal and Related Problems			
1. Is the new product patentable?			
2. Is its trade-mark protected?			
3. Are all claims to royalties or other indemnities settled?			
4. Do royalties limit the market for the product?			
5. Is there anything in the product, its labeling or advertising which may cause you to become involved in a possible violation of a Federal, State, or local statute or ordinance?			
6. Will codes, trade agreements, etc., restrict its sale in certain areas?			
7. Is there anything in your pricing policies, trade practices, or selling set-up that might involve a violation of Federal or other statute or ordinance?			
8. Have local tax and other problems been considered?			
9. Have all transportation problems been considered?			
13. Are there any special war or postwar regulations which affect your product?			
14. Are there any labor or union regulations which might affect your product?			
15. Are there any other problems, peculiar to your product, that should be considered?			

CHECK LIST TO HELP YOU INTRODUCE YOUR NEW INDUSTRIAL PRODUCTS

INTRODUCTION

What This Check List Does

Successful large corporations always assume that if a new industrial product is worth launching at all, it is worth launching right. They never take on a new product until they have had staffs of experts make elaborate and detailed investigations of every marketing and other problem involved. This is how they avoid costly blunders that might ruin the chances of the new product or even wreck the entire business.

Source: U.S. Bureau of Foreign and Domestic Commerce, Economic Series No. 53 (Washington, D.C., U.S. Government Printing Office, 1946), pp. v–vi, 1–23.

If your company is small, or if you are just organizing a company to make a new product, you probably can't afford to have full-time marketing experts on your staff. You should, though, consider engaging outside marketing assistance to help you make sound plans. And certainly the least you can do is to get your men together and try to anticipate as many as possible of the numerous problems that are going to confront you.

In this bulletin you have, in convenient "package" form, the most important questions that you must be able to answer to market your product efficiently and profitably. This bulletin will help you use some of the same care and foresight in marketing your new product that your larger competitors are accustomed to exercising. It will help you stop, look, listen, and *plan.*

Mill supply houses and other distributors who are interested in handling new industrial products will also find this check list useful.

WHAT THIS CHECK LIST DOES NOT DO

This guide is a marketing check list, not an engineering or production check list. But do not let this lead you to neglect the engineering and production angles. If your new product is designed poorly or produced at high cost even the best laid marketing plans won't make sales.

This bulletin will help you stop, look, listen, and *plan* on the marketing side. Before you launch your new product, however, make sure you have done equally careful planning on the product engineering and production engineering sides.

WHAT IS AN INDUSTRIAL PRODUCT?

Roughly speaking an industrial product is one used primarily by producers of goods and services, while a consumer product is one used primarily by individual consumers. A commercial tire retreading machine is an industrial product, while a home tube repair kit is a consumer product.

But this definition must be qualified as follows:

a. Many products are used both as industrial products and as consumer products. For example, some woodworking machinery is well adapted either to the home shop or to commercial production operations. The same principle applies to hand tools, work gloves, paint, steel wool, electric light bulbs, and many other products.

b. Industrial products and consumer products are often marketed through similar or identical channels. For example, hardware stores and general mail-order houses sell industrial-type items such as logging chain, truck jacks, power hack saws, and agricultural implements side by side with all sorts of consumer-type items.

c. The term industrial product covers so many different kinds of items that often they have little marketing similarity. For example, selling rolling-mill equipment to steel producers has little in common with selling a small specialty such as an improved one-quarter-inch brass drain cock. The latter item may get the most sales if it is mounted on small counter display cards—much as straps for wrist watches are sold. But rolling-mill machinery does not make a good counter display.

Therefore, bear in mind that your answer to every question in this guide must be keyed to the nature of, and the uses for, your new product.

If you decide that your industrial product also has possibilities for consumer use, or for distribution through consumer-goods channels, or both, then make use not only of this guide but also of the *Check List for the Introduction of New Consumer Products.*[1] It is a companion guide especially adapted to consumer products and their marketing.

How to Use This Check List

The questions in this Check List are self-contained and self-explanatory. The best way to fill in the answers is to get your associates together around a table and go through the entire list, line by line, pencil in hand. Use continuation sheets if there is not enough space for your answers to some questions.

Set up task groups of two or three associates to look more deeply into special problems. Find out how marketing and engineering consultants can help you.[2]

I. IS YOUR NEW PRODUCT SALABLE?

The *easy* way to "define" the market for your new product is to say something like "Every farmer, manufacturer, and transportation company needs something like this," or "Every city government in the country can save money using my product."

That is the *easy* way to convince yourself there is a big demand for what you want to sell. But it is never true! Markets don't happen that way! Every product's potential sales—even to a particular class of customers like airlines or building contractors—are limited by a number of factors. Competition is one factor, but there are others.

For example, every product's potential is limited by what the product itself is good for, by whether it can be produced efficiently enough to sell at a reasonable price, and by a variety of factors (reciprocal sales, for instance) over which you, as manufacturer or distributor, may have little control. It is natural to say that all industry needs your belt dressing or burglar alarm or burr remover; but some can't use it, others already have it, others can't afford it, others have always bought from a competitor.

So enthusiastic generalizations as to the size, location, or character of the market for your product are dangerous. The only sound, sensible way to determine the possible market for a product is to test, secure the facts, and consider all the factors involved.

First find out whether the product (designed and produced as you will design and produce it) is salable to typical, representative prospects. This section,

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[1] Editors' Note: See page 214.

[2] To line up marketing and engineering consultants, write the trade journals in your field and contact your trade associations, your local chamber of commerce, or your attorney, banker, or business acquaintances. Some advertising agencies also make market research studies. Often the best course for the smaller manufacturer is to find an engineer or marketing expert who will work on a fee basis for a number of small concerns, dividing his time and expense among them.

Section I, will help you take this step. Then determine the approximate net total number of such prospects you can count on. Section II will help you on that. Finally, let the remaining sections in this Check List help you plan how to get at your prospects.

CHECK LIST ON GENERAL SALABILITY

1. What do you call your new product?____________________
____

2. What will it probably be called by the trades?____________
____

3. What is it for?________________________________
____

4. In what sense is it new? (Is it a minor adaptation of something you are now making; a "standard" product newly added to your line; something new to this country but in use abroad; an entirely new technical development, or what?)____________________
____

5. Have you thought out exactly why you want to introduce this new product? Are you trying to:
   - *a.* Start a new business?.......................... ________
   - *b.* Start a new line?.......................... ________
   - *c.* Round out your present line?.......................... ________
   - *d.* Expand sales in your present market?.......................... ________
   - *e.* Invade an entirely new market (for example, the export market)? ________
   - *f.* Get better or more even use of your men and machinery?...... ________
   - *g.* Meet a new need of your customers?.......................... ________
   - *h.* Exploit an available patent?.......................... ________
   - *i.* Keep up with changing technological trends in your field?...... ________
   - *j.* Counter a new competitive product?.......................... ________
   - *k.* Do something else? (Describe.).......................... ________

   ____

6. Has your product had controlled laboratory or engineering tests to show up performance? (For example, if it is a new container, has it received breakage tests in a tumbling machine?)........... ________
7. Have you fully pre-tested your product under actual service conditions? Do you know how it will stand up in service?.......... ________
8. If products of this general type are already on the market, what features in them appeal most to users and distributors? (Rank in order of importance:)
   - *a.* Capacity or rate of output.......................... ________
   - *b.* Cost of operation.......................... ________
   - *c.* Durability.......................... ________
   - *d.* Ease of repair.......................... ________
   - *e.* Price.......................... ________
   - *f.* Service and maintenance.......................... ________
   - *g.* Compactness.......................... ________
   - *h.* Appearance and finish.......................... ________
   - *i.* Trade-in value.......................... ________
   - *j.* Multi-purpose usefulness.......................... ________
   - *k.* Safety features.......................... ________
   - *l.* Ease and simplicity of operation.......................... ________
   - *m.* Other (describe).......................... ________

   ____
   ____

9. What features do present products of this type have which users and distributors don't like? (For example, some plant engineers are biased against certain products; some lumberjacks prefer full polished axes; some cabinetmakers object to single twist-type wood bits; some machine-tool users prefer to buy tools finished in other colors than the standard gray.)________________________
____

10. How many of these good points and bad points in present products of this type are also found in your new product?
    a. Good points (list them)____________________________
    ____
    b. Bad points (list them)_____________________________
    ____

11. If there are no products like your new product on the market today, why, in brief, do you think the new product fills a need that is not now being taken care of?________________________
____

12. Have you fully pre-tested your product from the point of view of customer response? Have you tried it out on the type of people who will use it?. . . . .

13. Are you satisfied that your new product is the kind of product the market wants or can be taught to want? (If so, write down why in a couple of sentences.)__________________________________
____
____

II. HOW MANY USERS WILL THERE BE?

Every manufacturer or distributor wishes that he could count his "sure" prospects as easily as he can count his output. But he never can. You never have 3,000 or 3,000,000 prospects. Instead you have 3,000 or 3,000,000 prospects—*if*—if the product is right, if it is packed and shipped right, if the discounts are right, if business conditions are right.

Since so many factors enter into estimating the number of users, there is a great temptation to lapse into wishful generalities—unsupported by field tests or by arithmetic—in counting your prospects. Avoid that at all costs.

The questions in this section will help you to make an initial estimate and then to cut down that estimate realistically on the basis of stated limiting factors. The estimate must be cut still more in the light of later sections.

Check List on Number of Users

1. What industries will use the new product? (Are they farmers, manufacturers of mining machinery, long-haul truckers, or what? List those that first occur to you.)
    1. ____
    2. ____
    3. ____
    4. ____
    5. ____
    6. ____
    7. ____
    8. ____

2. Does your product have any possibilities for consumer use? (For example, if it is a new blowtorch, might it find use in home workshops as well as in industry?) (Note: If your product will have consumer use or will be sold in part through retail channels such as hardware stores or department stores, or both, you will also want to fill in a copy of the *Check List for the Introduction of New Consumer Products* . . . on page **.) . . . . ________
   If so, what?____
   ____
3. Can you count on selling any of your product to the Federal Government, including the armed forces? . . . . ________
4. Can you count on its being used by State and local governments? ________
5. How many potential customers (neglecting all competitors and other complicating factors) are there in this country? (In the columns below list *every* type of potential user—for example, meat packers or electric utilities—that you and your friends and associates can think of. Then on the basis of the U.S. Census of Manufactures, manufacturers' registers, and other sources . . . put an estimated number of prospects, either firms or individuals, opposite each type of user. For example, if your product were an improved electric glue pot, you would list all major users such as furniture factories and minor users such as individual cabinetmakers. Total each column and add the two totals.)

Primary Users		Minor Users	
Type	Number	Type	Number

Total primary users________________ Total minor users________________

Total *potential* users in U.S.________________________________

6. What factors cut down the size of the total market?
   - *a.* What percentage of the potential customers are located in sections of the country where there is little use for the product? (For example, southern municipalities need little snow-removal equipment. Industries in natural gas areas are not apt to buy automatic stokers.) .... __________
   - *b.* What percentage will be poor prospects because they use smaller-scale or larger-scale equipment than your product? (For example, bus companies in small towns may not be able to use automatic vehicle-washing equipment efficiently.) .... __________
   - *c.* What percentage are likely to be out of the market because they already have similar products giving satisfactory service? .... __________
   - *d.* What other market-limiting factors, if any, are peculiar to the nature of your product, and roughly by what further percentages might they reduce the size of your total market?

     .... __________

     .... __________

     .... __________

     Total .... __________
7. How many prospects are left for your type of product? (Reduce No. 5 by the percentage total in No. 6) .... __________
8. What additional percentage deductions in the estimated size of your total market must be made in the light of factors brought out in Sections V and VI? [1]
   - *a.* Deduction for the internal industry situation (patents and the like) (section V) .... __________
   - *b.* Deduction for competitors' inroads on your market (section V) __________
   - *c.* Deduction for price range (section VI) .... __________

     Total .... __________
9. How many prospects are available after these additional deductions? (No. 7 less the percentage total in No. 8) [2]
   Estimated total available prospects [2] .... __________
10. How many of your products would each typical prospect normally use per year? (If your product would last the typical prospect 5 years, then write 1/5.) .... __________
11. How many prospects can you then estimate for your product for the first year? (Multiply the number of available prospects by the average number of your product each one would use per year; that is, multiply No. 9 by No. 10.) [1]
    Estimated total available prospects for first year .... __________
12. Is the market for your type of product likely to change in size during the next 2, 5, or 10 years? .... __________
13. Are there foreign sales possibilities for your product? (If so, you may later want to estimate the number of prospects in various foreign countries. The Department of Commerce can give you much useful information on these foreign prospects. In most cases, however, you will want to establish a domestic market before branching out abroad.) .... __________

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[1] To be filled in after you have completed the Check Lists in sections V and VI.

[2] Available prospects, of course, does not mean sure sales. This total is your estimate of the number of possible sales available to you if you go get them.

III. WHAT ARE THE BUYING HABITS OF THE USERS?

When a businessman says he is "experienced" in marketing a certain line of products, one of the main things he means is that he knows on a first-hand basis the various trade practices in that *particular* line. For marketing pig iron is different from marketing agricultural machinery, and that is different from marketing machine tools. Marketing used machine tools is different from marketing new ones. Marketing hack-saw blades for power hack saws is different from marketing them for hand hack saws.

And so it goes. In some cases the trade practices and buying habits and procedures seem logical—for example, it makes sense that purchases of lumbering equipment are seasonal—but in other cases you can explain them only in terms of, "Well, that's the custom in this trade."

But whether buying habits in the field of your new product seem reasonable or (as in the case of trade discounts in some fields) clumsy and awkward, you have got to take them into account. To overlook some simple point like discounts might lose you half your sales. So, especially if the particular trade is new to you, make the maximum use of the following Check List and any other material and advice you can lay your hands on.

Check List on Users' Buying Habits

1. Are products of this type usually bought by users?
   a. For cash? .... ________
   b. On open account credit? .... ________
   c. On a time payment plan? .... ________
2. Will your product sell evenly throughout the year or (as with truck tire chains) will the bulk of the sales be concentrated in one or more seasons?
   a. Evenly .... ________
   b. Seasonally .... ________
3. If seasonally:
   a. When will your immediate customers buy? .... ________
   b. If your customers are not the final users, when will the users buy? ________
4. Is there any way to level out seasonal fluctuations in sales by balancing sales to different groups of purchasers? (For example, seasonal sales of agricultural machinery in one part of the country might be at least partly leveled out by sales in another part of the country or export sales.) .... ________
   If so, how? ____
   ____
   ____
5. Are purchasers of this type of product accustomed to buying it ahead of need, or do they tend to place spot orders for instant shipment?
   ____
6. Will some purchasers of your new product (for example, chain stores, mail-order houses, Federal, State or local governmental units) buy only on the basis of unusual technical specifications or other special buying procedures? .... ________
   If so, can you meet their requirements? .... ________

7. Are the potential users of your product accustomed to relying on trade names or firm names, or do they buy mainly on the basis of technical specifications?______________________
   a. If they buy mainly under trade names or firm names, do you have established names that you can sell under?.............. __________
   b. If they buy mainly according to technical specifications, will your product meet such specifications, and has your staff adequate knowledge and experience in doing business on these terms? __________
8. How do major users or distributors of the product negotiate for it?
   a. Do they buy from distributors or producers in the open market at established prices?.................................. __________
   b. Or do they place special orders with manufacturers for large-lot production?.. __________
   c. Or do they do both, depending upon circumstances?........... __________
   (Note: If principal users or distributors are in the habit of negotiating directly with small or other manufacturers for big lots at special prices, that may create opportunities and also problems for you. Such orders sometimes entail loss of independence on the part of the producer. For example, if one big distributor takes most of your output, you may be unable to sell effectively to others. And when the single distributor renews his contract, he may force the price down until your profit disappears. Meanwhile you may have lost touch with your old distributors. Therefore, think twice before agreeing to sell the bulk of your output to one or two distributors or users.)

IV. HOW WILL YOU DISTRIBUTE THE PRODUCT?

In order to get your product into the hands of the ultimate users you will ordinarily sell direct to the ultimate user or establish a channel of distribution through one or more distributors, or both. Choose the best distribution channels and then build up and maintain good relations with your distributors and customers.

Don't rely on preconceived notions in working out a distribution scheme for your new product. For example, it is not necessarily true that the distribution channels you are using for your present line, if you have one, are the best for your new product. Or again, don't get the idea that you can automatically cut costs and red tape by "eliminating all middlemen." Sometimes this works, but other times it is an expensive luxury.

It is usually smarter, more effective, and quicker to fit the distribution of your product into well-established trade channels and distribution procedures. But flexibility of outlook is, particularly for the smaller manufacturer, important here. For example, it might pay you to produce, on a pilot scale, just enough of your product to get the "bugs" out of it, to prove its salability, and to show that it is not likely to be the object of patent infringement suits before you go into full production.

CHECK LIST ON DISTRIBUTION

1. Briefly, in what parts of the country are the prospects you want to reach? (Note: Refer back to section II, question 5 where you have listed your prospects by type. Now, where are these prospects located geographically? It may pay you to locate concentrations of them with colored pins on regular maps or on special trade-area marketing maps obtainable from several companies. Your trade association or your local library, bookstore, or chamber of commerce will help you find such maps. Or consult the marketing experts at your State university.)
2. How, if at all, does the location of your prospects affect your plans for distribution channels? (For example, if your prospects are loosely scattered over the entire country, that might be an argument for distributing your product more through your own manufacturer's salesmen and less through industrial suppliers located in population centers.)
3. Have you considered the possibility that it might pay you, for a preliminary trial period, to confine distribution of your product to one or a few selected regions of the country?
4. Through what channel or channels are users accustomed to buying products of this kind?
   - *a.* Directly from the manufacturer's headquarters?
   - *b.* From manufacturer-owned outlets? (Note: Some manufacturer-owned outlets also handle goods produced by others.)
   - *c.* From manufacturers' agents?
   - *d.* From jobbers, wholesalers, mill supply houses, or other industrial distributors?
   - *e.* From general mail-order houses?
   - *f.* From retailers (including chain stores)?
   - *g.* From independent service outlets? (For example, V-belts for commercial refrigeration purposes are often sold through refrigeration service concerns.)
   - *h.* Other? (Describe.)
5. Put this question to yourself and your friends and associates: If *you* were going to buy a product of this type, from what outlets would *you* prefer to make your purchase?
6. What channel or channels do you actually plan to use? (List.)
7. If you plan to distribute the product in a manner unlike the way similar products are now usually distributed, or unlike the way you would prefer to buy the product if you were in the user's shoes, are you sure there are valid reasons for your decision?
8. On what sort of franchise, if any, do your competitors usually sell products like your new product?
   - *a.* Do they grant an exclusive nation-wide franchise?

b. Do they grant exclusive franchises for different regions of the country?.. ________

c. Do they distribute through several selected suppliers in each area or trade center?.................................. ________

d. Do they distribute generally through any or all suppliers (or any or all of certain types of suppliers) in each area who are willing to handle the product?.................................. ________

9. What do you expect to do about the franchise matter?________
____
____

10. If products like your new one usually have a service guarantee (either a factory guarantee or a distributor guarantee) will you and your distributors conform?.................................. ________

11. If products like yours are usually installed by the manufacturer or distributor, will you and your distributors conform?........... ________

12. Have you considered the best way of getting your product to your customers? Have you studied alternative carriers from the point of view of rates, territory served, accessibility to your plant, losses in transit, packaging requirements, speed in handling and transit, and so on? (Note: Railroads, trucking companies, and other carriers will be glad to furnish information on these points.)...... ________

13. Have you decided exactly how your product should be prepared for shipment?.. ________

14. Where will stocks of your product be maintained?________
____

15. Where will servicemen and spare-parts stocks be available?________
____
____

V. WHAT ABOUT COMPETITION?

As you put your new product on the market you will face competition from many directions. For example, you may think your new product is the last word in modern design, and yet some competitor may turn up with something better. Likewise your production methods, while good, may not be so good as the other fellow's. Again, your competitors may enjoy access to cheap credit which will help them cut their costs below yours. Or they may distribute their product more efficiently.

Smaller companies are particularly apt to neglect the product design side and the marketing side of effective competition. Always remember that no matter how well designed your new product may be, somebody may improve on it in time. You had better be the one who does the improving, or competition will hit you hard. Likewise, remember that a competitor may do such a good job of putting his product before potential buyers that his sales will outstrip yours even if the product is engineered not quite as well as yours.

On the engineering side, your best defense is a technical offense. No matter how unique you may think your new product is, you cannot rest on your technical oars or find permanent shelter behind patents. Particularly if you run a small business and cannot rely on large established laboratories of your own, you had better set aside a certain percentage of your profits on the new product for the sole purpose of doing research to help you maintain and increase whatever engineering advantages your product now enjoys. Plan short-term, medium-term, and long-range research programs to keep your product in the forefront. Industrial history is littered with examples of small companies that started out prosperously with a product that was technically supreme in its field, only to let competitors strangle them through research that undermined all the product's original competitive advantage.

As for effective competition on the marketing side—well, that is the reason for this Check List. All the questions in it relate to effective industrial marketing under competitive conditions. The questions in this section are particularly pertinent.

Check List on Competition

1. What firms make products that will compete with your product?
   1. ____________________
   2. ____________________
   3. ____________________
   4. ____________________
   5. ____________________
   6. ____________________
   7. ____________________
   8. ____________________
   9. ____________________
   10. ____________________
2. Briefly, what advantages has each competitor over your company? (For example, in terms of nearness to the market.)____________
   ____
   ____
3. What is the reputation of:
   a. Leading competitive firms?____________________
   b. Leading competitive products?____________________
4. Do you know of competitors or potential competitors who are likely to enter the field with products similar to yours?........... ________
   a. If so, what is their reputation____________________
   b. Do they have enough technical or marketing skill so that they may develop a better product or market it better?............ ________
5. Can anybody bring out a seriously competitive item quickly?..... ________
   a. Do you have basic patents that would reduce the likelihood of sudden and unexpected competition?....................... ________
   b. Are there engineering or other factors that would reduce the possibility of unexpected competition?...................... ________
6. To what extent do "unrelated" products indirectly compete with your new product? (For example, domestic washing machines indirectly compete with commercial laundry equipment.)__________
   ____
   ____
   ____
7. Do past, present, and prospective technological developments give any indication of whether this indirect competition will increase in the future?.. ________
8. Are changes in materials or methods likely to reduce the need for your product? (For example, increased use of plastics might, by reducing the need for machining metal parts, decrease the sales of a manufacturer of milling cutters.)........................... ________

9. Are changes in materials or methods likely to increase your present competitors' sales at the expense of your own? (For example, increased use of light metals might favor a competitive maker of milling cutters who had designed a line especially for cutting light metals.) .... ______

10. Have you discussed with your engineering or research staff all important past, current, and prospective technological trends that may affect your competitive situation? (If you have no research or engineering people, have you located some unbiased and foresighted outside research advice and made the fullest use of it?) .... ______

11. Is your name and reputation already established in the minds of the people who will distribute your new product and the people who will use it with respect to:
    - *a.* Similar product you may already make? .... ______
    - *b.* A general reputation for quality and engineering progressiveness? ______
    - *c.* A general reputation for dependability, stability, honesty, and fair dealings? .... ______

12. In the light of your own standing or lack of standing in the market for your new product, is it best to trade on your company name in introducing the product, or would it be easier and more satisfactory to build up a separate name for the product itself? (Note: It will pay you to investigate the way other companies in your field have handled this problem.) ______

______

______

______

13. Can your product compete favorably with similar products on the market:
    - *a.* As to price? .... ______
    - *b.* As to quality? .... ______
    - *c.* As to performance? .... ______
    - *d.* As to finish and appearance? .... ______
    - *e.* As to durability and length of service? .... ______
    - *f.* As to length of service guarantee? .... ______
    - *g.* As to other guarantees? .... ______
    - *h.* As to package or method of packing? .... ______
    - *i.* In other respects? (List them.) .... ______

______

______

______

14. Has your product received controlled engineering performance tests side by side with the products of your competitors? (Note: Such tests, especially when performed by an independent outside laboratory, often provide an excellent basis for advertising and promotional work and for building dealerships.) .... ______

15. What unique *operating* advantages, if any, can you claim for your product over those of your competitors? (For example, does it turn out work faster, or is it a multi-purpose piece of equipment that can be used for more different operations, or does it require less skill to run, or what? Concisely, list all undeniable points of superiority—that is, all points that distributors and users as well as the maker will agree on.) ______

______

______

______

______

16. What other advantages, if any, can you claim for your product as against those of your competitors? (For example, is its first cost less, or does it require less floor space, or is it designed to be serviced with standard rather than special tools?)________________

17. Do customers buy your competitors' products mainly on the strength of:
    - *a.* Technical specifications?.................................... ________
    - *b.* Reputation of the company?................................ ________
    - *c.* Reputation of the brand or trade name?...................... ________
    - *d.* Other factors (for example, reciprocal sales arrangements, company affiliations, personal friendships, etc.)? (Describe)________

18. If you cannot match certain special services provided by your competitors, can you provide equal value by quoting lower prices or otherwise?.. ________
    If so, will customers be satisfied? (Note: In practice, buyers are often unwilling to substitute a lower price for special services.).... ________
19. Will the internal situation (reciprocal buying agreements, patent licensing agreements, trading area agreements, and the like) in the industry limit the number of prospects as estimated in section II, question 7?.. ________
    If so, what percentage cut must you make in the estimate? (Note: Enter this in the appropriate space in section II, question 8*a*.).... ________
20. In figuring your total sales prospects you have got to make allowances for your competitors—unless you think you will have no competitors, or that you can reduce their sales to zero. So by which of the following methods will you carve out your place in the available market?
    - *a.* By reducing total competitors' sales for this type of product?.. ________
    - *b.* By expanding the demand for the product so you can sell your full output without cutting the sales of your competitors?...... ________
    - *c.* Partly by cutting competitors' sales and partly by increasing total effective demand?.................................. ________
21. In the light of question 20, what approximate further percentage cut, in addition to that required by question 19, must you make in the estimate of section II, question 7? (Note: Enter this figure in the appropriate space in section II, question 8*b*.).................. ________

VI. WHAT ABOUT PRICE POLICY?

It is obvious that the price (both to distributors and to final users) of your new product must be in line with competitors' prices for the same quality, service, and performance. Discounts, allowances, and the like must also have some relation to established practices in the field. This means that you need a thorough knowledge of pricing structures as well as other trade practices and customs in the field of your new product.

In order to get your new product introduced to distributors and users, you may have to set up a liberal system of discounts and allowances. But bear in mind that many a manufacturer has run aground on overgenerous discounts which he could not easily abandon.

Here are three important principles in setting a price policy:

1. Be sure that your scale of prices, discounts, and allowances is in line with long-standing trade practices.

2. Be sure that discounts and allowances are such that everybody who plays a part in distributing your product not only can, but in practice will, make a satisfactory net profit.

3. Be sure that your prices to different types of distributors, as well as the promotional and other help you give each type, do not permit some of your distributors to compete unfairly with others. Discrimination between distributors is not only unfair but illegal. Federal and State anti-price-discrimination statutes prohibit any discrimination between individual distributors or other buyers. These laws do not prohibit quantity discounts or similar concessions, but they require that such concessions must be on an equal basis to all qualified distributors.

CHECK LIST ON PRICE POLICY

1. Do you know, in general, what your price policy will be on this product?.......... __________
2. Have you figured your profit margin as accurately as possible?.... __________
3. Have you clearly decided whether you want to follow a big-volume-small-margin price policy or a small-volume-big-margin price policy?.......... __________
4. If in your price policy you are shooting at a relatively limited group of prospects, should you further reduce the total potential prospects estimated in question 7, section II?.......... __________
   If so, by what percentage? (Note: Enter this figure in appropriate space in question 8, section II.).......... __________
5. Are you sure your price schedule on the new product will meet the requirements of all your logical prospects?.......... __________
6. Have you considered insurance costs as well as costs of manufacture and selling in determining your price?.......... __________
7. Have you considered all transportation costs, including basic rates, yard and switching charges, if any, and other handling costs?..... __________
8. Have you considered packaging and packing costs?.......... __________
9. How will installation costs, if any, affect the price policies of you and your distributors?.......... __________
10. Will you service or help service the product?.......... __________
    If so, will the user pay you directly for the service?.......... __________
11. Will you expect your distributors to help service the product?..... __________
12. How will performance guarantees, if any, affect your costs and prices and those of your distributors?__________
    ____
    ____
13. Will you sell spare parts at cost or at a profit?.......... __________
14. Have you worked out a complete factory price schedule for spare parts?.......... __________
15. If your distributors will also handle spare parts for your product, have you worked out spare-parts price schedules for sales to them and suggested prices for resale to users?.......... __________

16. Have you decided what classes of customers will be entitled to trade discounts?
17. Have you determined the schedule of trade discounts to:
    a. Distributors? (Note: Refer back to question 4, section IV.)
    b. Users (for example, governmental agencies) to whom you may sell direct?
18. Will you offer a cash discount to your customers?

VII. THE SALES PROGRAM

A. THE SALES FORCE

A salesman who is a wonder at selling a consumer product like vacuum cleaners may be a complete failure selling an industrial product like thickness planers for dressing lumber. There are plenty of reasons why this is so, but one of the most important reasons is this: Selling industrial-type products takes more specialized knowledge and training regarding the product and its applications.

The old saying that in some lines the less a salesman knows about his product, the better job he is apt to do, is decreasingly true for consumer products and never was true for industrial-type products. The purchaser of an industrial product is not apt to buy on the basis of superficial appearance or reputation of the product or on the basis of a mere whim that he would enjoy having the item. Industrial product purchases are mostly serious purchases, and the purchaser is held responsible by his company for whatever choices he makes. As a result, he is inclined to buy according to the best technical information he can get.

Scientific purchasing is here to stay. In the next few years, with all sorts of promising new products being thrown on the market, distributors and users of industrial products will probably buy more and more on the strength of exact technical information. This means that your salesmen need full and exact knowledge of your product and its performance characteristics and an imaginative insight into its uses and applications.

CHECK LIST ON THE SALES FORCE AND SELLING

1. Have you made some estimate, in terms of direct-selling costs, of what it ought to cost you per unit to promote and sell your product? (Note: If you have made such an estimate, you may want to modify it in the light of the questions in this section.)
2. Do you have a sales force which is already handling other products?
3. If you do not now have any sales force of your own will you need to create one?
4. If you do have a sales force:
    a. Can the existing sales set-up—just as it is—take on your new product and do justice to it without harming the sale of your regular line?
    b. Or will you need to change or expand your present organization?
    c. Or would it be best to establish an entirely separate sales staff to handle the new product?

5. If you decide to expand or change your present organization to handle the new product, will you need to:
   a. Increase the size of the staff?.............................. ________
   b. Decrease the size of territories?.............................. ________
   c. Give your salesmen special training to sell the new product?... ________
   d. Take other similar steps? (List them.)________________
   ____
   ____

6. Will your salesmen "sell" the new product in the sense of actually closing sales, or will they "negotiate" sales which the management will close?________________________________
   ____

7. How seriously would sales of the new product be affected by a business recession?________________________
   a. If the new product is the only one you make, would it be more, or less, susceptible to a business recession than most industrial products?________________________
   b. If you also make or handle other products, would sales on them be more likely or less likely to be hit by a business slump than sales on the new product?________________

B. ADVERTISING—SALES PROMOTION

Advertising and sales promotion are like air and artillery support for ground troops. Their function is generally to soften up resistance and make it easier for the ground troops (in this case, the salesmen) to accomplish their objectives. And as with a combat team, sales promotion and advertising must not only be intelligently conceived and executed, but they must be well coordinated with the other marketing weapons. Advertising and sales promotion must be aimed at the right targets, they must be big enough and sustained enough to do the job assigned to them, and—most important of all—they must be used in the right places and at the right time. Indiscriminate large-scale advertising expenditures do not necessarily mean profitable sales.

It is usually harder to measure the effects of advertising and other sales-promotion activities than it is to measure the results of production. But production and sales promotion are alike in that in both fields you can formulate sound general principles. They are also alike in that they should both be carried on by specialists, or at least with the help of specialists.

In many cases it will pay the medium-sized or small manufacturer to have an advertising and sales-promotion specialist on his staff. If you can't afford to do that, at least get the advice and help of somebody who knows the field well. Perhaps you can line up an advertising consultant or agency on a fee basis.

Whether or not you will be hiring an outside consultant or agency, here are three additional steps that will pay you:

1. Study, especially from the point of view of promoting products like your product, the advertising journals and a selection of the best books and handbooks. You may want to appoint a task group in your organization to do this job.

2. Investigate the advertising and sales-promotion technique used by your

competitors. Collect samples of their advertising. Include your indirect as well as direct competitors in the study. (For example, if you wanted to promote a new industrial-type floor sander for painters, carpenters, boat builders, and the like, you would do well to study not only the sales-promotion methods used by other makers of heavy-duty floor sanders, but also the methods used by makers of floor refinishing supplies and equipment intended for use by householders.)

3. On the basis of these studies, the following Check List, any other advice or written materials you can obtain, and some imagination, prepare a complete advertising and sales-promotion plan for your new product.

Check List on Advertising and Sales Promotion

1. Have you formulated general policies for promoting your product among:
   - a. Users? .... ________
   - b. Distributors? .... ________
2. Do you know in detail the sales-promotion and advertising methods used by the competitors you will face in this field? .... ________
3. Do you know the sales-promotion practices followed by distributors in reselling your type of product? .... ________
4. Do you intend to launch immediately into advertising and sales-promotion activities to boost your product or would it be better to begin later?
   - a. It would be better to begin now .... ________
   - b. It would be better to begin later .... ________
5. Are most of your prospects already accustomed to using products of this type, or will they have to be taught to use them? .... ________
6. If they have to be taught, do you have a plan for teaching them? ________
7. What engineering and design features of your product can you especially stress in your advertising and promotional work? (Note: Refer back to questions 13–16, section V.)________

   ____

   ____

   ____

   ____
8. What message, in general, will be the basis of your advertising appeal?________________________________

   ____

   ____

   ____

   ____
9. What message will form the basis of your *opening* promotional effort?________________________________

   ____

   ____

   ____
10. Have you determined how much and what type sales-promotion assistance you will need to give your own salesmen to help them sell to distributors or users, or both? (For example, what engineering advice, market data, printed catalogs, drawings, samples, brief-case portfolios, educational slides or films, or scale models could they use?) .... ________

11. What general advertising and promotional support (for example, catalogs, hand-out circulars, dealer display materials) will you give your distributors? (Note: Adapt such support carefully to the nature of your product. For example, some small specialty items handled by industrial distributors can be mounted on counter cards for most effective dealer sales promotion.) ____________________

____

____

12. Have you planned sales and service manuals, parts lists, tables of shipping weights and measures, and the like for the use of distributors and users of your product? .... ________
13. What advertising media will you use?
    - *a.* Business papers? .... ________
    - *b.* Daily newspapers? .... ________
    - *c.* Direct mail? .... ________
    - *d.* Telephone directories? .... ________
    - *e.* Consolidated industrial catalogs? .... ________
    - *f.* Manufacturers' registers? .... ________
    - *g.* Other media? List .... ________

    ____

    ____

    ____

    ____

14. Do you know whether your competitors are carrying on any newspaper or other organized publicity efforts (as distinguished from advertising) to make their products more familiar and acceptable to distributors and users? .... ________
15. Do you plan to use such publicity? .... ________

VIII. WHAT ABOUT LEGAL AND RELATED PROBLEMS?

There are certain legal problems—for instance, those relating to the patent situation on your new product—that you should look into before you make any plans even for pilot-scale production. The following Check List helps indicate these problems.

Your marketing plans should also be checked from the legal viewpoint. For example, every producer or distributor who engages in interstate commerce must bear in mind the antitrust laws, including the Sherman Act, Clayton Act, Robinson-Patman Act, Miller-Tydings Act, Federal Trade Commission Act, and certain other Federal statutes. You can find summaries of these statutes in the loose-leaf business services and in other sources available in libraries; or your attorney will interpret them to you.

More complicated, because there are so many of them, are the State and local laws, ordinances, and regulations having to do with production and marketing. For example, most States have laws regulating unfair trade practices. Some cities require certain types of salesmen to have licenses. Some States have passed laws designed to cut down or eliminate sales of out-of-State products which compete with certain local industries. Cities, towns, and counties have health and safety laws, building codes, and sanitary codes which often prohibit the use of certain types of construction materials or the installation of certain types of equipment.

Check List on Legal and Related Problems

1. Is ownership of the new product established? Are you sure you know who controls all the rights in it?........................ ______
2. Are all outstanding claims to royalties or other indemnities settled so that you are sure you have a right to make the product, and on what royalty or other terms you have a right to make it?........ ______
3. Have you, or whoever else controls the product, secured maximum patent and trade-mark protection for it?...................... ______
4. What patent or similar restrictions, if any, are there on the production, distribution, sale, or use of your new product? (For example, some patent licensing agreements specify that the licensee shall distribute his output only in certain geographic areas.)...... ______

   ____

   ____
5. Are there any such restrictions affecting the production, distribution, sale, or use of parts, accessories, or supplies that are needed to operate, maintain or repair your new product?...................... ______

   If so, what?______________________________

   ____

   ____

   ____
6. Are any materials, parts, or sub-assemblies which you need to turn out your new product hedged by similar restrictions?............ ______

   a. If so, what are the restrictions?______________________________

   ____
7. Do Government regulations (Federal, State, or local) in any way restrict the production, sale, or use of this type of product or significantly raise the costs of producing, marketing, or operating it? (For example, State and Federal health laws sometimes require modification of production methods.)........................ ______

   If so, how?______________________________

   ____
8. Will marketing agreements or other industry agreements in any way limit the production, sales, or use of your new product? (Refer back to section V.).. ______
9. Are there any labor or union regulations that might affect the shipment, installation, servicing, or use of your product?............ ______

   If so, what?______________________________

   ____

   ____
10. Is there anything in the labeling or advertising of your product that might get you involved in a violation of a Federal, State, or local statute or ordinance?................................... ______
11. Is there anything in your pricing policies, trade practices, or selling set-up which might involve a similar violation?................. ______
12. Have you considered all local licensing and tax problems?........ ______
13. Are there any other legal problems, peculiar to your product, that you should consider?.. ______

    If so, what are they?______________________________

    ____

    ____

COST FORECASTING AND PRICE POLICY

JOEL DEAN

The central question of this paper is: "How should cost estimates be used to do a better job of setting prices?" In dealing with this question, our concern will be with the way to get answers to pricing problems, rather than with the answers themselves; and our focus will be on principles rather than techniques. This analysis will be confined to costs of production (*i.e.*, *handling* the business); it will exclude selling costs (*i.e.*, costs of *getting* business).

COST CONCEPTS AND COST FUNCTIONS

There are a variety of cost concepts, each useful under some circumstances and misleading or worse under others. Effective use of costs for setting prices requires a clear understanding of the principle of different costs for different purposes.

Future costs, not current or past costs, are relevant for most price policy decisions. A strategy of using price as an instrument of market development requires bold action in anticipation of higher sales and consequent economies of volume. There are, normally, practical impediments to frequent changes in price. Moreover, it takes time for its full volume effects to be felt. A basic price decided on today is likely to far outlast the conditions that determine today's costs. Therefore it is forecasts of tomorrow's costs that are needed.

Cost behavior is the result of many forces. Determination of the functional relationships of costs to each major force provides the informational foundation for the various cost forecasts that are useful for pricing decisions.

Knowledge of cost functions provides a foundation which has the necessary flexibility to develop the multiple-condition conjectures that are needed. Practical demand estimates usually cover a range of sales volume, because of estimating error and uncertainty about fluctuations in national income and other influences; hence it is necessary to be equipped to conjecture costs for various volumes and for different combinations of cost conditions, *e.g.*, 15 per cent higher wages, 20 per cent less output, 10 per cent greater efficiency.

Clearly, forecasts, based upon these cost functions, are subject to estimating error. But this does not destroy their usefulness. It is impossible for management to escape guessing about future costs when it makes a pricing decision. The choice lies between forecasting explicitly and adopting the viewpoint of the ostrich. No careful forecast could be as inaccurate as the tacit assumption that current costs will continue indefinitely. Yet that is exactly the assumption that is made when price decisions are reached on the basis of "actual costs."

Source: Presented before the New York meetings of the American Marketing Association, June, 1947, and published in *The Journal of Marketing*, Vol. XIII, No. 3 (January, 1949), pp. 279–288. Reprinted by permission.

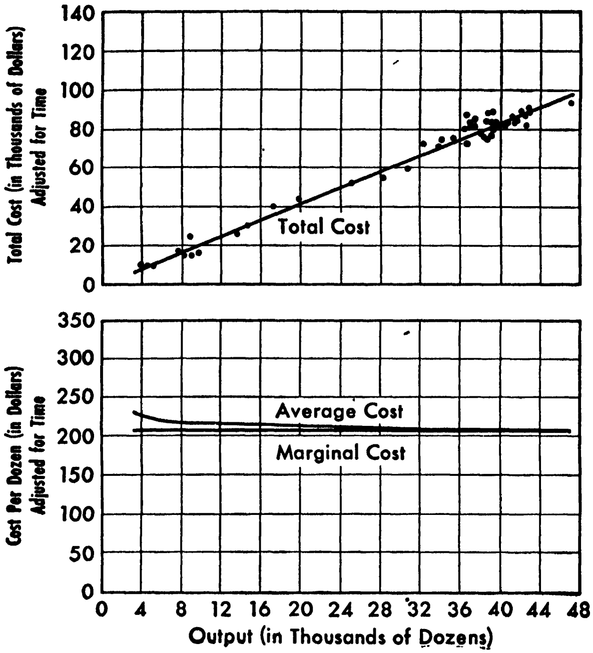

FIGURE 1

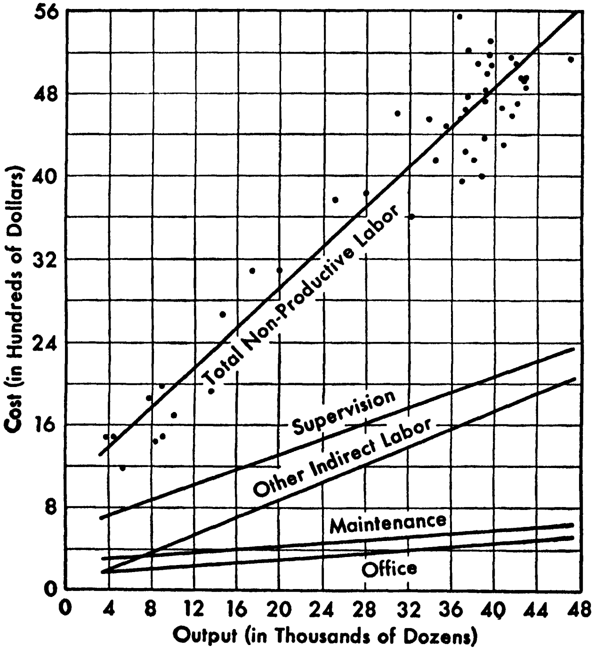

FIGURE 2

Now let us briefly examine some of the more important kinds of cost functions and see how each can be used for more scientific pricing. We shall confine our attention to the relation of costs to: (1) rate of output, (2) size of lot, (3) size of plant, (4) wage rates and material prices, and (5) technology.

Rate of Output Curve. The cost curve for output rate is illustrated by three charts. Figure 1 shows results of a statistical determination of costs for a hosiery mill. Total cost rose at a constant rate over the prewar range of output. This resulted in an average cost which declined over the whole range and a marginal production cost which was constant. There is some reason to expect that this kind of cost behavior is quite general in manufacturing industries in normal times. Figure 2 shows how various components of cost behave when output is varied. You will note wide differences in sensitivity to output. Findings for the Coat Department of a large New York store are shown in Figure 3.

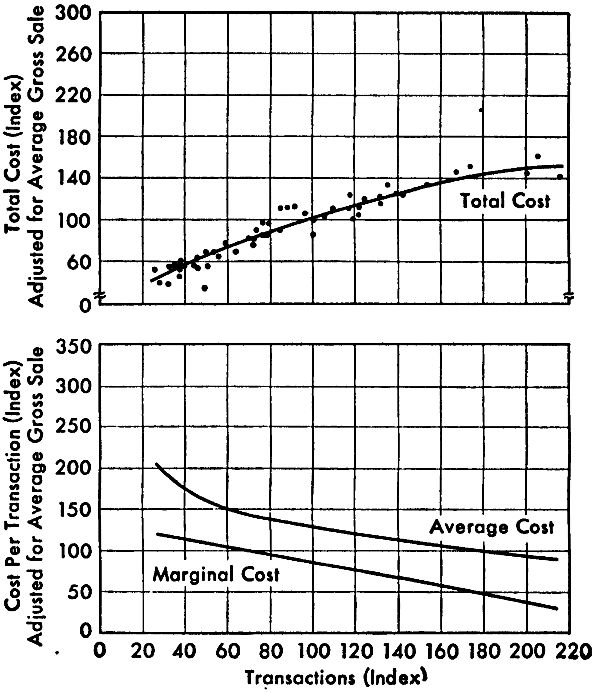

FIGURE 3

This sort of short-run cost curve has several valid uses for pricing: (1) It provides the groundwork for short-run comparative income statements to test the profit effects of alternative basic prices. (2) It is the basis for estimates of short-run incremental costs which are useful for setting various kinds of price differentials and for market segmentation. (3) It is also useful in estimating how much volume increase would have to result from price concessions in order to obtain specified levels of profitability. A high proportion of companies can develop, quite cheaply, a short-run production cost curve of this type, which is accurate enough for pricing purposes.

Lot Size Curve. The relationship between cost and the number of units in a production (or distribution) lot is easy to understand and to estimate. If the set-up costs (or other constant costs) are large and the economies of lot size are therefore marked, then projections of cost curves for lot size have wide usefulness for price policies. It may be a factor in determining the basic price level.

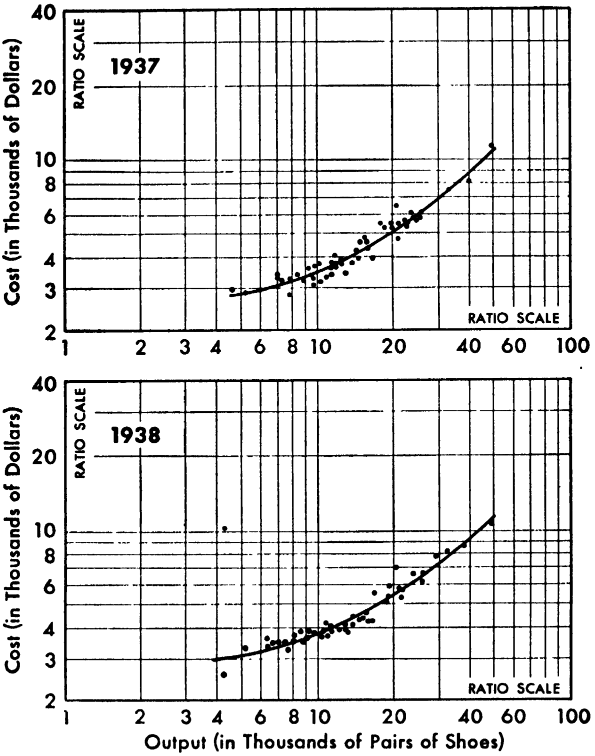

FIGURE 4

Pricing to develop volume markets frequently contemplate economies of lot size as well as of scale, output rate and technology. Forecasts of lot-size economies also underlie quantity discount structures and package size differentials. Also such economies are responsible for some of the differences in costs among models and hence affect price differentials for quality, size, use, etc.

Size of Plant Curve. The way unit costs will behave as plant size is expanded is illustrated by the empirical cost curve for size of store shown in Figure 4 in a shoe chain. Another method that is more appropriate for many situations is engineering estimates of a plant's expansion path.

Long-term cost estimates play an important role in decisions on the basic price because plant expansion is often entailed. When price is used as a major instrument of long-range market development, estimates of the economies of scale play a major role in testing the probable profitability of reductions. For example, when a major insurance company was deciding whether to reduce the price of policy loans, it projected costs at various volumes far beyond the range of past experience. These were paired with revenue estimates to test the earnings consequences.

Wage Rates and the Price Level. Should your price move up and down with the general price level? The general price level is a statistical fiction. A glance at the individual price relatives that are summarized in the various indexes of the price level shows the bewildering disparity among the individual price movements. They move not only at different rates but also in different directions.

The impact of the price level upon your price works through various kinds of goods: (1) Products that are substitutes (direct or indirect) for your product. (2) Goods that siphon off purchasing power otherwise available for your product, and (3) Goods and services that are components entering into the cost of making your product. Instead of keeping your price in some arbitrary relationship to the general price level, it is far more useful to recognize and study each of these types of impact separately and arrive at a pricing decision. They differ in degree and even in direction. Moreover, the first two affect demand estimates and the third affects your costs.

Projections of future costs on the basis of changed wage rates and material prices are needed for many pricing problems. For most decisions, replacement costs, rather than costs historically incurred, are needed. This principle applies with equal force to equipment and plant (where they are relevant) as to finished inventory and goods-in-process.

In applying this principle, the first step is to make some estimates. What will happen to your material prices and wage rates in the near and distant future? The next step is to determine the impact of these estimated changes upon your costs. In the near term, when substitutes and improved methods and technology can be virtually ignored, this is largely a matter of arithmetic. Even here these factors-price changes do not affect all costs proportionately. Hence their consequences should be estimated separately for various concepts of cost and for various products. For the most distant future, the estimates should take account of the possibility that cheaper materials will be found, methods will be improved, and technical advances will displace man hours.

Technological Cost Curve. Since pricing decisions of today stretch into the distant future they must be made in contemplation of continued technological advance. Guessing technical improvements is bound to be inaccurate, yet it is likely to be far less wrong than operating on the tacit assumption that technology will stand still. But this is exactly the assumption that is made when no effort is made to project innovations. Methods for estimating technical advance include (1) surveying the specific technical advances that are now upon the horizon and tracing their cost-reducing consequences for your company and (2) projecting the past trend of technical advance in your industry.

This brief survey of cost curves shows that different problems call for different kinds of cost conjectures. Projection on a scientific basis involves knowledge of the relationship of cost to each of these factors. This framework of knowledge of cost curves makes it possible to combine factors flexibly and thus produce without special research a variety of cost estimates suitable for various purposes.

HOW TO USE COSTS FOR SETTING THE BASIC PRICE

A useful distinction can be made between the problem of setting the *basic price* and of setting the structure of *price differentials.* The basic price, for a single-product firm, is a price bench mark for stating price differentials for differing quantities, locations, distribution channels, etc. For a multiple-product company the basic price is less definite. But frequently the price of the prototype product of the high-volume product serves as a bench mark for model differentials among a group of closely related products as well as for quantity and channel discounts.

Let us first look at determination of the basic price for a firm making several products.

Cost Plus Is Wrong. Only in the last decade have economists had sense enough to sit at the feet of businessmen and try to find out systematically how executives really go about setting prices. Two studies of this type have been made in England, and two comprehensive ones have been under way for several years in this country. The most striking finding is that an overwhelming majority of businessmen say they set prices on the basis of cost plus a fair profit. By "cost" they usually mean full cost at current levels. By a "fair profit" it is hard to know what they mean. No one ever seems to want more than a fair profit.

The respondents probably tend to overstate the rigidity of this pricing rule, for many of them introduce the afterthought of "adjustment to take account of competitive conditions." Hence the cost formula may be a pricing ideal which is actually attained less frequently than these surveys indicate.

The popularity of the cost-plus method does not necessarily mean it is the best available method. In most situations it is the wrong attack on the pricing problem, for several reasons: (1) It ignores demand. What people will pay for a product bears no necessary relationship to the costs incurred by the manufacturer. (2) It involves circular reasoning: unit cost depends on volume but sales volume depends on the price charged. (3) It fails to adequately reflect competition. Buyers' alternatives in the form of substitute products are all omitted from this simple formula and the effect of a price upon rivals' reactions and upon the birth of potential competition is also neglected. (4) It concentrates on the wrong cost. Not current cost and certainly not past cost but forecasts of future costs are needed for the limited role of costs in setting prices.

Types of Valid Uses. The dominant factor in pricing should be the estimated effect of price on sales volume, the effect on buyers' actions and attitudes, rivals' reactions, potential competition, etc. Cost estimates play a secondary, facilitating role. What are the valid uses for pricing? They may be roughly classified into three groups: (1) To measure the effects of the alternative prices upon profits. (2) To guess what people will do in response to a proposed price. (3) To justify a course of price action already decided upon.

1. Effects on Profits. Measurement of the effects of proposed prices on profits presupposes estimates of expected volume at different prices. But cost estimates are an essential element in choosing between proposed prices, since they make it possible to project and compare the probable profits from alternative price-volume combinations.

This can be done by drawing up comparative operating budgets that show the probable earnings that will result from each potential price under consideration. To get these comparative budgets, cost projections based upon the relationships of cost to output rate, plant size, technology, price levels and to other conditions are needed.

2. Effect on Actions of Buyers and Competitors. There are several kinds of practical uses of cost estimates to aid in guessing what people will do in response to proposed price: (*a*) estimating the demand for some types of producers' goods by making an analysis of users' probable cost savings; (*b*) guessing rivals' reactions; (*c*) predicting impacts on potential competition.

a. Buyers' Alternative Costs. The demand for capital goods is largely governed by the way the product affects the buyers' costs. Hence prices should be geared to buyers' alternative costs by estimating the amount of cost savings of various types of customers. Price thinking should be focused upon the customer's payout period, and upon user costs as compared with his existing and alternative equipment. An example of the approach is a producer of a petroleum additive who bases his price, not on his costs, but on what it will cost his customers to obtain the same product properties by alternative means.

b. Guessing Rivals' Reactions. More direct methods of predicting competitors' concurrence in price action are probably widely used. But when they are not used, or when they still leave uncertainty, cost estimates can be of some help.

For this purpose it is the competitor's probable costs of the supplies rather than your own costs that are relevant. Your costs serve merely as a point of departure in estimating theirs. Knowledge of the cost hierarchy of your industry and the technology and size of rivals' plants is important for translating your cost figures into estimates of competitors' costs. A major oil company in setting prices in its leadership area estimates the costs of its best situated competitor to indicate the likelihood that its price lead will be followed. Recently one of the large magazines contemplated an increase in advertising rates. To guess whether this lead would be followed by competitors, it developed cost estimates and conjectural income statements at present prices and at proposed prices for its major rivals. This analysis indicated that a cost squeeze would force rivals to follow the increase.

c. Potential Competition. The effects that your price will have upon entry into your industry, and upon expansion is a long-term factor of importance in pricing. You can price competitors *into* your market as well as yourself *out* of it. Here again cost estimates are useful in guessing the effect of your price upon unborn competitors.

Stay-out pricing is the cornerstone of the pricing philosophy of many leading producers of automotive parts and accessories. Their big customers stand at the threshold of producing the product themselves. Some already have one strategic foot in the door. Projections of the costs of these potential invaders should be a major pricing factor.

Only if your own current costs are really the best estimate you can make of potential competitors' cost, should this consideration lead to prices based solely on your own average costs. Costs of existing plants are sometimes significantly higher than those of new entrants with up-to-date technology.

3. **Justification of Price Action.** Cost is frequently used to justify a course of price action already decided upon. Examples include satisfying the government that the provisions of the Robinson-Patman Act have been met, justifying prices before a regulatory commission, and convincing customers that the price rise was "necessary."

Costs have become a sort of social conscience in pricing. This notion springs from the precept of the classical economists that price tends to equal cost of production under conditions of perfect competition. Because this dream of atomistic competition has been used by economists as a norm of desirable price behavior, costs have grown to perform a normative function. In public-utility regulation, for example, full cost plus a fair return on capital is a regulatory standard. This public-utility thinking has been carried over into business in a distorted form in the practice of full cost plus a fair profit. Yet an aggregate earnings standard and a unit margin standard are not the same thing at all. This guide, at most, stills complaint and yields peace of mind. But it is a hazardous standard of practical price-making. It yields a price which you perhaps "ought to get," but not one that you necessarily can get. As a social conscience it ought to be *expected* replacement cost by the most technically advanced plant—not "actual costs."

INVERTED RELATION OF COST TO PRICE

Frequently the relation of cost to price is, in practice, inverted. The practical problem is to tailor costs to fit a pre-determined selling price. A manufacturer of model airplane building sets, for example, starts with a target retail price and works backward by first deducting estimated retail and wholesale margins, then deducting desired manufacturers' profit, and finally selecting the components whose costs will not exceed what money is left over. Similarly, the economic strategy of product development for many firms, notably chemical companies, is similarly inverted. The problem is to develop a substitute which will capture the market presently held by a specified chemical in a specific industrial use. This means that the unborn chemical must sell at a pre-determined displacement price, and that the guide for the entire process of product search, development, production and costing is a pre-determined price.

This approach, though fully usable only in special situations, has important pricing lessons for most manufacturers. First, it starts with market price realities and looks at the problem from the viewpoint of what the buyers want and will pay for. Second, it views the seller's costs as susceptible of reduction—not as immutable facts. Third, it views the product not as sacred but as a modifiable vehicle for satisfying specified consumer wants.

SETTING THE STRUCTURE OF PRICE DIFFERENTIALS

What is the role of cost in reaching decisions about the structure of price differentials and what concepts and projections of cost are useful and valid? Most practical problems involve a *change* in the existing differentials, rather than the creation of a new pattern from whole cloth. Incremental costs, accordingly, play a strategic role. They make it possible to compare the additional revenue with the resulting additional cost in order to maximize the incremental contribution to profits and overhead.

The kinds of price differentials that present practical pricing problems may be classified as follows: quality differentials (*e.g.*, standard vs. de luxe models; regular vs. "fighting" brands); size spreads (*e.g.*, 3-ton vs. 5-ton trucks); use differentials (*e.g.*, royalty leasing of patents and machinery; fluid milk vs. cheese milk); load-factor differentials (*e.g.*, morning movie prices and off-peak electric rates); style cycle progressions (*e.g.*, merchandise mark-downs, and edition differentials); trial discounts (*e.g.*, introductory subscriptions to magazines and to services); quantity discounts (*e.g.*, order-size discounts and package size differentials); distribution channel differentials (*e.g.*, wholesale vs. retail prices; private brand vs. house brand); and geographical differentials (*e.g.*, zone pricing, basing point pricing, etc.).

Product Line Pricing. The problem is to fix the relationships of prices among your products. What kinds of products need to be priced in relationship? What kinds independently? In principle, only products whose demands are importantly inter-related must be considered together in pricing. Relationship on the cost side, through common production of distribution processes, has no bearing here. Common costs reduce the accuracy of estimates of the costs of individual products, but should not affect the relation of product prices. Joint products should be priced independently unless they are related in demand. Demand interdependence includes products that are similar in use and hence are potential fringe substitutes, or products that complement one another in use or in the sellers' market strategy.

A common way of setting the price of such kindred products is to estimate the full costs, including overheads, of each and apply a uniform percentage markup. This is easy and definite, but it is usually not the best way to go about it. The various qualities, sizes, editions, etc., of the product are likely to tap market sectors differing in demand elasticity and in competitive intensity. These demand differences should be the controlling determination of price differences.

A constructive approach to problems of this type is to view the product variants as opportunities for market segmentation in order to tap added markets and to separate sectors of the market which differ in demand elasticity. For example, multiple editions of books are a means of successively exploiting more and more elastic sectors of the market. Viewed thus the technical problem of product line pricing is to obtain the most profitable degree and kind of price discrimination.

Relevant consideration for setting product differentials includes: (1) Relative buyer-benefits obtained from the product variants (*i.e.*, the use value in different applications and sections of the market). (2) Degree of competitive superiority of your product. (3) Intensity of competition. (4) Comparative elasticity of demand of the market segments tapped by each product. (5) Cross elasticity of demand among your products. (6) Future revenue consequences upon customer goodwill. (Prices that are proportional to sellers' allocated costs are sometimes thought to have magical effects upon buyers' goodwill.) (7) Promotional effects of introductory model pricing (*e.g.*, loss leaders, introductory subscriptions, equipment subsidies to stimulate sales of parts). (8) Effects upon profits of alternative schedules of differentials best studied by effects on total contribution to overhead and profits.

From this list it is apparent that the role of cost estimates in product-line pricing should be a secondary one. Their most important job is to help project the earnings consequences of contemplated product differentials. Estimates of total cost before and after, paired with comparable estimates of total receipts, are needed for this job. The impacts upon total costs of more sales or of less sales of the various products can often be most practically projected by using the incremental cost of the various products.

Incremental cost has other important uses here. It can be used as a bench mark for finding the best pattern of market segmentation and price discrimination. The spread between incremental cost and price represents the product's contribution to overhead and profits. This spread should be studied in measuring the profit effects of alternative prices and in deciding upon product additions and product deletions. Hence incremental costs play a strategic role in maximizing this marginal contribution by price structure decisions.

Where common overhead costs are important, increment costs can often be approximated by using traceable costs. The allocation of overhead costs to individual products is quite arbitrary and is subject to wide errors; moreover many of the overhead items may not vary with output and hence have no short-run marginal cost. Orthodox allocations are often more misleading than useful in estimating incremental costs. This approach does not imply that prices should be *equal* to incremental costs—far from it. Nor does it mean that prices of related products should be *proportionate* to their marginal costs. The margin between price and incremental cost should normally differ among related products. And these differences should not be determined by the theology of cost accounting. Instead they should be governed by the demand and competitive considerations cited above. Thus, estimated incremental cost is a practical economic sill—it sets the minimum of bed rock pricings, it serves as a valid point of departure for demand pricing and provides an efficient vehicle for tracing effects on total costs and profits.

Cost estimates sometimes have still another function in product price differentials. A study of the comparative costs of various kinds of users gives a clue to the use value and buyers' benefits of producers' goods.

Royalty licensing represents in some respects a sort of ideal of market segmentation pricing that is keyed to user costs and user benefits and is admirably divorced from irrelevant sellers' costs.

Quantity Discounts. A sound quantity discount policy requires estimates of the relationship of your cost to the relevant dimensions of quantity. The Robinson-Patman Act is construed as limiting quantity discounts to the savings of the seller (although it makes an exception "to meet competition"). Key questions in studying this relationship include: Does cost vary more closely with account size (*i.e.*, the volume of annual purchases), or with the size of the individual order? How big are the savings of case lots?

Many prewar cost analyses now badly distort the present and future cost relationships. The universality of the unprofitable small customer problem (*e.g.*, 80 per cent of the customers accounting for 20 per cent of the volume and 10 per cent of the profits) may indicate that many quantity discount structures need a check-up. Possibly price has not been adequately used as an instrument of selective selling.

Cost estimates should not *determine* the quantity discount structure; instead they should be used: (1) to help select the *basis* of discounts that is appropriate for your business (*e.g.*, annual sales or order size); (2) to mark out legal limits for the amount of discounts; (3) to estimate the impact on your profits of adopting alternative schedules of quantity discounts.

As stated at the outset, cost estimates should play second fiddle to demand in pricing decisions. But even though demand estimates are rudimentary and have wide error ranges, it is usually helpful to have the relevant cost estimate for each type of price decisions, provided they are not too expensive. For most established enterprises with normally adequate records, cost functions may be developed quite economically that will give adequately accurate cost forecasts—by almost anyone who takes the trouble to find out what is known about cost curves and who employs some ingenuity and insight in developing simplified short cuts. The expense of cost estimates is further reduced because the basic cost relationships have clear usefulness for other kinds of business policy.

IV. MARKETING STRUCTURE AND CHOICE OF DISTRIBUTION CHANNELS

SELECTED DATA ON CHANNELS OF DISTRIBUTION[1]

SALES, MARGINS, EXPENSES

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[1] In addition to the sources of these exhibits, various trade associations, private research organizations, governmental agencies, and educational institutions are engaged in compiling data on sales volume and distribution costs. The student may find many of these indicated in *Distribution Costs—An International Digest*, by McNair, Teele, and Mulhearn (Boston, Harvard Graduate School of Business Administration, 1941).

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EXHIBIT I

UNITED STATES SUMMARY OF RETAIL TRADE

Comparison of Stores and Sales: 1929, 1935, and 1939

Kind of Business	Number of Stores			Sales, 1939			
	1929	1935	1939	Amount (000 omitted)	Percentage of Total	Percentage Change from 1929	Percentage Change from 1935
Total, all stores *	1,476,365	1,587,718	1,770,355	$42,041,790	100.0%	−13%	+28%
Food group	481,891	532,010	560,549	10,164,967	24.2	− 6	+22
Grocery stores (without fresh meats)	191,876	188,738	200,303	2,225,435	5.3	−35	+ 1
Combination stores (groceries and meats)	115,549	166,233	187,034	5,496,318	13.1	+41	+32
Dairy products stores, milk dealers	8,478	16,380	16,834	740,011	1.8	+ 2	+28
Meat markets, fish markets	49,865	39,474	42,360	750,797	1.8	−44	+23
Candy, nut, confectionery stores	63,265	55,197	48,015	295,300	0.7	−48	− 6
Fruit stores, vegetable markets	22,904	32,632	27,666	222,239	0.5	−28	+ 3
Other food stores	29,954	33,356	38,337	434,867	1.0	−20	+50
General stores (with food)	104,089	66,701	39,688	810,342	1.9	−68	−27
General merchandise group	54,636	44,651	50,267	5,665,007	13.5	−12	+23
Department stores	4,221	4,201	4,074	3,974,998	9.5	− 9	+20
Dry goods and general merchandise stores	38,305	28,709	29,247	713,208	1.7	−40	+35
Variety stores	12,110	11,741	16,946	976,801	2.3	+ 8	+25
Apparel group	114,296	95,968	106,959	3,258,772	7.8	−23	+23
Men's and boys' clothing, furnishings, hat stores	28,197	20,914	21,501	773,312	1.9	−35	+17
Family clothing stores	10,551	7,881	10,053	429,454	1.0	−22	+20
Women's ready-to-wear stores	18,253	21,975	25,820	1,009,494	2.4	− 7	+27
Accessories, other apparel stores	33,036	26,231	29,098	429,448	1.0	−29	+30
Shoe stores (all kinds)	24,259	18,967	20,487	617,064	1.5	−24	+21
Furniture-household-radio group	58,941	45,215	52,827	1,733,257	4.1	−37	+34
Furniture stores	25,153	17,043	19,902	973,157	2.3	−36	+40
Other home furnishings stores	8,820	9,776	12,012	226,727	0.5	−25	+44

Household appliance, radio dealers	24,968	18,396	20,913	533,373	1.3	−43	+22
Automotive group	69,379	50,459	60,132	5,548,687	13.2	−21	+31
Motor-vehicle dealers (new)	42,204	30,294	33,609	4,810,245	11.4	−23	+29
Used-car dealers	3,097	4,751	6,980	193,790	0.4	+38	+59
Accessory, tire, battery dealers	22,313	14,343	18,525	523,685	1.3	−13	+40
Other automotive	1,765	1,071	1,018	20,967	0.1	−43	+39
Filling stations	121,513	197,568	241,858	2,822,495	6.7	+58	+43
Lumber-building group	52,814	36,553	39,667	1,761,205	4.2	−33	+59
Lumber and building-materials dealers	26,377	21,149	25,067	1,478,459	3.5	−25	+71
Heating, plumbing, paint, electrical stores	26,437	15,404	14,600	282,746	0.7	−56	+19
Hardware group	37,572	36,633	39,646	973,709	2.3	−20	+28
Hardware stores	25,330	26,996	29,147	629,276	1.5	−11	+35
Farm implement-tractor-hardware dealers	12,242	9,637	10,499	344,433	0.8	−34	+18
Eating places	134,293	153,468	169,792	2,135,020	5.1	+ 0	+28
Drinking places	....	98,005	135,594	1,385,032	3.3	....	+91
Drug stores	58,258	56,697	57,903	1,562,502	3.7	− 8	+27
Liquor stores (packaged goods)	....	12,105	19,136	586,351	1.4	....	+79
Other retail stores	173,618	139,135	172,375	3,496,437	8.3	−28	+34
Fuel, ice, fuel-oil dealers	19,118	35,293	41,172	1,013,542	2.4	+ 0	+18
Hay, grain and feed stores	21,394	11,132	16,772	623,977	1.5	−37	+80
Farm and garden supply stores	5,740	9,176	4,915	155,312	0.4	+21	−38
Jewelry stores	19,998	12,447	14,559	361,595	0.8	−33	+54
Cigar stores, cigar stands	33,248	15,350	18,504	207,781	0.5	−49	+14
Florists	9,328	11,242	16,055	148,741	0.3	−16	+51
News dealers	10,285	7,071	7,407	72,427	0.2	−52	+17
Other retail stores	54,507	37,424	52,991	913,062	2.2	−36	+57
Secondhand stores	15,065	22,550	23,962	138,007	0.3	− 7	+22

* Previously published totals for the United States and for the automotive group, for 1929 and 1935, are revised to exclude service garages and other automotive service businesses whose receipts from service sales exceed their sales of merchandise. These are now included in the Census of Service Establishments.

Source: U.S. Bureau of the Census, *Census of Business: 1939, Retail Trade* (Washington, Government Printing Office, 1941), Vol. I, Part 3, Table 1*A*, p. 5.

EXHIBIT 2

UNITED STATES SUMMARY OF RETAIL TRADE: 1939

Part 1. Stores and Sales, by Types of Operation

Type of Operation	Number of Stores[a] 1939	Sales: 1939		Percentage of Total Sales	
		Amount (000 omitted)	Percentage of Total	1929	1935
Total—all types	1,770,355	$42,041,790	100.0%	100.0%	100.0%
Independents[b]	1,624,665	31,409,859	74.7	77.6	73.3
Single store	1,521,145	27,417,200	65.2	68.7	64.9
Multiunit[c]	77,845	3,752,509	8.9	8.8	7.9
Market and roadside stands[d]	18,014	103,162	0.3	[l]	0.3
Leased departments—independent	7,661	136,988	0.3	0.1	0.2
Chains[e]	123,195	9,105,825	21.7	20.3	23.3
Local chains[f]	25,455	1,581,386	3.8	6.7	3.1
Sectional[g] or national chains	82,049	6,771,009	16.1	12.6	19.5
Manufacturer-controlled chains[h]	10,123	583,062	1.4	0.7	0.4
Leased-department chains	5,568	170,368	0.4	0.3	0.3
Other types[i]	22,495	1,526,106	3.6	2.1	3.4
Utility-operated stores	4,836	151,539	0.4	0.3	0.4
Direct selling (house to house)[j]	5,199	153,397	0.4	0.2	0.4
Commissaries or company stores	2,007	148,248	0.3	0.3	0.3
Farmer and consumer cooperative stores	3,698	224,375	0.5	0.2	0.3
State liquor stores	2,618	249,430	0.6	.....	0.5
Mail-order houses[k]	434	537,413	1.3	1.0	1.3
Other types of operation	3,703	61,704	0.1	0.1	0.2

[a] Number of retail establishments.

[b] Three or fewer stores under one management-ownership.

[c] Two- or three-store organizations; and local branch systems, such as found in the furniture and department store fields.

[d] Not including roadside stands at which the farmer sells his own produce.

[e] Four or more units.

[f] Substantially all units in and around a single city.

[g] Stores in different cities in the same state or in a single section of the country.

[h] Stores distributing the products of a manufacturer or a group of manufacturers who are joint owners.

[i] Sub-group considered as major basis of classification. For instance, utility-operated stores are classified as such, regardless of other characteristics.

[j] Central offices or multiunit headquarters of crews of canvassers.

[k] Not including retail stores operated by mail-order concerns.

[l] Less than 1/10 of 1%.

Source: U.S. Bureau of the Census, *Census of Business: 1939, Retail Trade*, "Types of Operation" (Washington, D.C., U.S. Government Printing Office, 1941), Table 3*A*, p. 5.

EXHIBIT 2 (*Continued*)

UNITED STATES SUMMARY OF RETAIL TRADE: 1939

Part 2. Stores and Sales, by Kinds of Business and Types of Operation

Kind of Business and Type of Operation	Number of Stores 1939	Sales: 1939		Percentage of Total Sales	
		Amount (000 omitted)	Percentage of Total	1929	1935
Grocery stores (without fresh meats)	200,303	$ 2,225,435	100.0%	100.0%	100.0%
Independents	179,335	1,491,473	67.0	53.6	61.3
Chains	20,093	720,427	32.4	45.7	38.3
Direct selling (house to house)	263	3,456	0.2	0.7	0.2
Commissaries or company stores	307	4,597	0.2		0.1
Other types	305	5,482	0.2		0.1
Combination stores (groceries-meats)	187,034	5,496,318	100.0	100.0	100.0
Independents	166,276	3,366,153	61.3	67.6	60.7
Chains	20,257	2,112,092	38.4	32.2	39.1
Commissaries or company stores	166	6,557	0.1	0.2	0.1
Other types	335	11,516	0.2		0.1
Dairy products, milk dealers	16,834	740,011	100.0	a	a
Independents	13,603	418,408	56.5		
Chains	3,076	306,028	41.4		
Other types	155	15,575	2.1		
Candy, nut, confectionery stores	48,015	295,300	100.0	a	100.0
Independents	45,579	242,183	82.0	.....	84.2
Chains	2,223	51,043	17.3	.....	13.8
Other types	213	2,074	0.7	.....	2.0
Department stores	4,074	3,974,998	100.0	100.0	100.0
Independents	1,371	2,312,279	58.2	72.1	61.4
Chains	2,672	1,194,517	30.0	16.7	26.7
Mail-order houses	24	464,289	11.7	11.2	11.7
Other types	7	3,913	0.1		0.2
Variety stores	16,946	976,801	100.0	100.0	100.0
Independents	10,555	128,909	13.2	9.8	9.2
Chains	6,372	847,686	86.8	90.1	90.8
Other types	19	206	b	0.1	b
Men's-boys' clothing, furnishings, hat stores	21,501	773,312	100.0	100.0	100.0
Independents	19,621	598,737	77.4	77.9	78.2
Chains	1,816	171,579	22.2	21.2	21.2
Other types	64	2,996	0.4	0.9	0.6
Family clothing store	10,053	429,454	100.0	100.0	100.0
Independents	8,935	352,639	82.1	71.5	79.0
Chains	1,082	532	17.8	27.3	20.9
Other types	36	76,283	0.1	1.2	0.1

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[a] For footnotes see p. 274.

Exhibit 2 (*Continued*)

United States Summary of Retail Trade: 1939

Kind of Business and Type of Operation	Number of Stores 1939	Sales: 1939		Percentage of Total Sales	
		Amount (000 omitted)	Percentage of Total	1929	1935
Women's ready-to-wear stores	25,820	$ 1,009,494	100.0%	100.0%	100.0%
Independents	22,424	694,119	68.8	74.3	72.3
Chains	2,880	263,102	26.1	22.7	25.2
Leased departments	386	31,705	3.1	3.0	1.7
Other types	130	20,568	2.0		0.8
Shoe stores (all kinds)	20,487	617,064	100.0	100.0	100.0
Independents	13,215	253,822	41.2	53.5	43.4
Chains	5,721	306,816	49.7	38.0	50.0
Leased departments	1,522	52,549	8.5	8.5	6.3
Other types	29	3,877	0.6		0.3
Furniture stores	19,902	973,157	100.0	100.0	100.0
Independents	19,091	829,830	85.3	83.9	86.0
Chains	784	141,864	14.6	14.2	13.5
Other types	27	1,463	0.1	1.9	0.5
Household appliance dealers	11,095	294,518	100.0	a	a
Independents	5,007	92,436	31.4		
Chains	1,214	53,973	18.3		
Leased departments	252	5,147	1.7		
Utility-operated stores	4,449	138,635	47.1		
Direct selling (house to house)	162	4,028	1.4		
Other types	11	299	0.1		
Radio-household appliance dealers	6,907	190,180	100.0	a	a
Independents	6,529	160,020	84.1		
Chains	169	19,392	10.2		
Leased departments	49	1,514	0.8		
Utility-operated stores	123	7,436	3.9		
Direct selling (house to house)	29	332	0.2		
Other types	8	1,486	0.8		
Radio stores—other	2,911	48,675	100.0	100.0	100.0
Independents	2,831	39,122	80.4	79.0	75.8
Chains	70	9,292	19.1	19.1	23.1
Other types	10	261	0.5	1.9	1.1
Motor-vehicle dealers (new)	33,609	4,810,245	100.0	a	100.0
Independents	33,272	4,679,450	97.3	.....	95.6
Chains	327	129,789	2.7	.....	4.4
Other types	10	1,006	b	.....	b
Accessory, tire, battery dealers	18,525	523,685	100.0	a	100.0
Independents	14,500	287,519	54.9	.....	50.0
Chains	4,017	235,961	45.1	.....	50.0
Other types	8	205	b	.....	b

EXHIBIT 2 (*Continued*)

UNITED STATES SUMMARY OF RETAIL TRADE: 1939

Kind of Business and Type of Operation	Number of Stores 1939	Sales: 1939		Percentage of Total Sales	
		Amount (000 omitted)	Percentage of Total	1929	1935
Filling stations	241,858	$2,822,495	100.0%	100.0%	100.0%
Independents	230,460	2,495,741	88.4	66.0	77.9
Chains	10,291	288,370	10.2	33.8	21.5
Cooperatives	1,017	35,304	1.3	0.2	0.5
Other types	90	3,080	0.1		0.1
Lumber, building-material dealers	25,067	1,478,459	100.0	[a]	100.0
Independents	19,181	1,177,407	79.6	.....	75.6
Chains	5,781	295,582	20.0	.....	23.9
Other types	105	5,470	0.4	.....	0.5
Paint, glass, wallpaper stores	8,480	152,673	100.0	[a]	100.0
Independents	7,427	111,269	72.9	.....	76.7
Chains	1,039	40,586	26.6	.....	23.0
Other types	14	818	0.5	.....	0.3
Hardware stores	29,147	629,276	100.0	100.0	100.0
Independents	28,641	600,921	95.5	94.6	96.1
Chains	444	25,413	4.0	3.0	3.9
Other types	62	2,942	0.5	2.4	[b]
Restaurants, other eating places	169,792	2,135,020	100.0	100.0	100.0
Independents	164,401	1,830,039	85.7	86.1	84.8
Chains	5,087	297,440	13.9	13.6	14.8
Other types	304	7,541	0.4	0.3	0.4
Drug stores with fountain	39,452	1,205,241	100.0	[a]	100.0
Independents	36,191	877,695	72.8	.....	71.2
Chains	3,240	326,549	27.1	.....	28.8
Other types	21	997	0.1	.....	[b]
Drug stores, other	18,451	357,261	100.0	[a]	100.0
Independents	17,532	282,825	79.2	.....	84.3
Chains	885	73,713	20.6	.....	15.5
Other types	34	723	0.2	.....	0.2
Liquor stores (packaged goods)	19,136	586,351	100.0	—	100.0
Independents	15,889	316,899	54.1	—	48.2
Chains	621	19,875	3.4	—	1.8
State liquor stores	2,618	249,430	42.5	—	49.8
Other types	8	147	[b]	—	0.2
Fuel, ice, fuel-oil dealers	41,172	1,013,542	100.0	100.0	100.0
Independents	39,763	857,333	84.6	80.1	82.8
Chains	1,134	152,681	15.1	18.3	16.5
Other types	275	3,528	0.3	1.6	0.7

EXHIBIT 2 (*Continued*)

UNITED STATES SUMMARY OF RETAIL TRADE: 1939

Kind of Business and Type of Operation	Number of Stores 1939	Sales: 1939		Percentage of Total Sales	
		Amount (000 omitted)	Percentage of Total	1929	1935
Hay, grain and feed stores	16,772	$ 623,977	100.0%	[a]	100.0%
Independents	14,379	445,538	71.5	.....	71.6
Chains	1,233	74,442	11.9	.....	16.0
Cooperatives	1,144	103,729	16.6	.....	11.7
Other types	16	268	[b]	.....	0.7
Farm and garden supply stores	4,915	155,312	100.0	[a]	100.0
Independents	4,384	106,676	68.7	.....	75.1
Chains	121	12,535	8.1	.....	4.7
Cooperatives	331	25,583	16.5	.....	17.8
Mail-order	36	8,251	5.3	.....	1.7
Other types	43	2,267	1.4	.....	0.7
Jewelry stores	14,559	361,595	100.0	100.0%	100.0
Independents	13,993	321,746	89.0	93.0	90.4
Chains	540	38,014	10.5	6.4	9.4
Other types	26	1,835	0.5	0.6	0.2
Cigar stores, cigar stands	18,504	207,781	100.0	100.0	100.0
Independents	16,886	150,060	72.2	73.5	61.9
Chains	1,533	56,300	27.1	25.1	35.8
Other types	85	1,421	0.7	1.4	2.3
Florists	16,055	148,741	100.0	[a]	100.0
Independents	15,933	144,109	96.9	.....	96.5
Chains	102	4,558	3.1	.....	3.5
Other types	20	74	[b]	.....	[b]
News dealers	7,407	72,427	100.0	[a]	100.0
Independents	6,051	52,501	72.5	.....	68.7
Chains	1,342	19,766	27.3	.....	30.7
Other types	14	160	0.2	.....	0.6
All other kinds of business	455,572	6,712,992	100.0	100.0	100.0

[a] Comparable data not available.

[b] Less than 1/10 of 1%.

Source: U.S. Bureau of the Census, *Census of Business: 1939, Retail Trade*, "Types of Operation" (Washington, Government Printing Office, 1941), Table 3*A*, pp. 5–6.

Exhibit 3

Part 1. Index of Sales of Retail Stores by Kinds of Business, 1941–1944

(1935–1939 = 100)

	1941	1942	1943	1944
All retail stores	143.5	148.8	164.7	179.1
Durable goods	164.1	103.6	98.2	104.5
Automotive group	165.7	55.1	53.4	55.0
Motor vehicle dealers	166.1	46.3	42.7	42.2
Parts and accessories	162.3	144.7	161.9	184.1
Building materials and hardware group	157.8	155.2	137.5	146.6
Lumber and building materials	160.2	153.1	136.8	142.9
Farm implements	149.4	140.6	109.8	112.0
Hardware	156.4	169.8	156.3	177.4
Home furnishings group	163.7	153.8	141.6	157.2
Furniture and house furnishings	165.5	168.5	165.2	184.1
Household appliances and radios	160.0	123.0	91.9	100.6
Jewelry	190.5	244.5	312.9	325.5
Nondurable goods	136.7	163.6	186.3	203.4
Apparel group	135.5	169.3	206.1	222.1
Men's clothing and furnishings	134.8	159.4	184.2	197.1
Women's apparel and accessories	138.8	178.6	237.5	260.3
Family and other apparel	135.0	164.8	202.3	217.7
Shoes	130.2	167.1	174.4	181.1
Drug stores	126.4	151.6	179.6	197.4
Eating and drinking places	158.6	204.2	265.7	308.1
Filling stations	138.8	121.4	98.5	104.6
Food group	134.5	168.5	186.6	202.6
Grocery and combination	135.7	171.6	187.6	203.6
Other	130.5	158.7	183.4	199.6
General merchandise group	126.3	143.6	158.9	172.9
Department including mail order	134.1	148.6	163.6	180.5
General including general merchandise with food	93.8	109.6	123.2	131.4
Dry goods and other general merchandise	127.1	162.3	192.8	208.1
Variety	131.5	150.8	159.4	167.1
Other retail stores	146.4	180.9	213.7	226.5
Feed and farm supply	147.5	222.3	304.3	310.6
Fuel and ice	129.0	151.0	163.8	152.5
Liquor	154.2	208.7	248.1	292.7
Other	155.9	169.0	185.8	208.3

EXHIBIT 3 (*Continued*)

Part 2. Dollar Sales of Retail Stores by Kinds of Business, 1941–1944

(In millions)

	1941	1942	1943	1944
All retail stores	$55,490	$57,552	$63,680	$69,275
Durable goods	15,604	9,846	9,339	9,931
Automotive group	8,544	2,840	2,751	2,834
Motor vehicle dealers	7,794	2,171	2,003	1,983
Parts and accessories	750	669	748	851
Building materials and hardware group	3,862	3,799	3,366	3,588
Lumber and building materials	2,435	2,326	2,079	2,171
Farm implements	524	493	385	393
Hardware	903	980	902	1,024
Home furnishings group	2,611	2,453	2,258	2,507
Furniture and house furnishings	1,787	1,820	1,785	1,989
Household appliances and radios	824	633	473	518
Jewelry	587	753	964	1,002
Nondurable goods	39,886	47,706	54,341	59,344
Apparel group	4,157	5,193	6,323	6,814
Men's clothing and furnishings	1,096	1,296	1,497	1,602
Women's apparel and accessories	1,690	2,175	2,893	3,170
Family and other apparel	605	739	907	976
Shoes	766	983	1,026	1,066
Drug stores	1,821	2,185	2,588	2,845
Eating and drinking places	4,796	6,173	8,034	9,314
Filling stations	3,454	3,021	2,453	2,604
Food group	12,576	15,755	17,450	18,947
Grocery and combination	9,604	12,141	13,276	14,402
Other	2,972	3,614	4,174	4,545
General merchandise group	7,931	9,015	9,977	10,853
Department including mail order	5,027	5,566	6,132	6,763
General including general merchandise with food	991	1,158	1,301	1,388
Dry goods and other general merchandise	738	943	1,119	1,208
Variety	1,175	1,348	1,425	1,494
Other retail stores	5,151	6,364	7,516	7,967
Feed and farm supply	1,101	1,660	2,272	2,319
Fuel and ice	1,260	1,475	1,600	1,489
Liquor	767	1,037	1,234	1,456
Other	2,023	2,192	2,410	2,703

Source: Adapted from U.S. Department of Commerce, Release No. 12397, 1945.

EXHIBIT 4

UNITED STATES SUMMARY OF WHOLESALE TRADE: 1939

Part 1. Number of Establishments, Sales, and Operating Expenses, by Types of Operation

Type of Operation	Number of Establishments *	Sales † (000 omitted)	Operating Expenses ‡	
			Amount (000 omitted)	Percentage of Sales
Total—all types	200,573	$55,265,640	$5,518,456	10.0%
Service and limited-function wholesalers	101,627	23,641,924	3,023,627	12.8
Wholesale merchants	91,323	18,688,897	2,540,959	13.6
Voluntary group wholesalers	703	753,586	85,586	11.4
Converters (textile)	631	425,167	41,152	9.7
Export merchants	586	778,001	59,537	7.7
Importers	2,158	1,379,575	114,418	8.3
Industrial distributors	1,471	729,650	121,687	16.7
Cash-and-carry wholesalers	1,198	108,902	5,994	5.5
Drop shippers or desk jobbers	937	474,891	30,380	6.4
Wagon distributors	2,398	80,259	9,813	12.2
Retailer-cooperative warehouses	222	222,996	14,101	6.3
Manufacturers' sales branches (with stocks)	12,977	8,846,940	1,191,188	13.5
Manufacturers' sales offices (without stocks)	5,119	4,679,262	324,175	6.9
Petroleum bulk stations and terminals	30,825	3,807,908	420,646	11.0
Independent bulk stations	6,357	627,674	76,126	12.1
Commission stations	17,530	1,080,479	108,084	10.0
Salary stations	6,053	1,739,676	205,199	11.8
Cooperative bulk stations	665	37,962	5,057	13.3
Distributing terminals	220	322,117	26,180	8.1
Agents and brokers	20,903	11,201,035	307,752	2.7
Auction companies	649	434,283	14,062	3.2
Brokers (merchandise)	4,710	3,390,695	51,327	1.5
Commission merchants	2,758	2,748,072	69,163	2.5
Export agents	654	571,449	16,591	2.9
Import agents	394	343,105	6,698	2.0
Manufacturers' agents (with stocks)	1,907	252,056	29,372	11.7
Manufacturers' agents (without stocks)	7,871	1,144,961	46,138	4.0
Selling agents	1,487	1,741,777	64,132	3.7
Other agents	473	574,637	10,269	1.8
Assemblers (mainly farm products)	29,122	3,088,571	251,068	8.1
Assemblers of farm products	9,866	792,159	50,432	6.4
Commission buyers	1,523	121,704	3,941	3.2
Cooperative marketing associations	2,583	611,029	70,048	11.5
Cooperative sales agencies	191	578,939	17,572	3.0
Cream stations	3,870	48,564	3,901	8.0
Country grain elevators—independent	3,180	271,154	15,975	5.9
Country grain elevators—line	4,061	226,917	15,877	7.0
Country grain elevators—cooperative	1,843	196,430	10,828	5.5
Packers and shippers	2,005	241,675	62,494	25.9

* Number of places of business.

† Total receipts, excluding returns by customers or allowances to customers, but including sales taxes.

‡ Not including withdrawals by proprietor-owners of unincorporated businesses, and not including imputed interest on investment.

Source: U.S. Bureau of the Census, *Census of Business: 1939, Wholesale Trade*, "Business-Size Groups and an Analysis of Operating Expenses" (Washington, Government Printing Office, 1941), Table 1, p. 8.

EXHIBIT 4 (*Continued*)

UNITED STATES SUMMARY OF WHOLESALE TRADE: 1939

Part 2. Number of Establishments, Sales, and Operating Expenses of Wholesale Merchants and Industrial Distributors, by Kinds of Business

Kind of Business	Number of Establishments *	Sales † (000 omitted)	Operating Expenses ‡	
			Amount (000 omitted)	Percentage of Sales
Wholesale merchants and industrial distributors §	92,794	$19,418,547	$2,662,646	13.7%
Amusement and sporting goods	1,255	135,765	26,558	19.6
Bicycles and supplies	40	5,005	899	18.0
Cameras and photographic supplies	105	12,356	2,404	19.5
Motion-picture equipment and supplies (except films)	64	9,950	1,511	15.2
Motion-picture film exchanges	203	22,269	4,272	19.2
Sporting goods	224	36,720	6,786	18.5
Toys, novelties, and fireworks	481	37,950	8,080	21.3
All other	138	11,515	2,606	22.6
Automotive	7,912	1,954,834	214,821	11.0
Automobiles (new and used)	567	1,300,976	65,253	5.0
Trucks and tractors	577	66,296	11,639	17.6
Automotive accessories and equipment	2,827	257,123	59,971	23.3
Automotive parts	3,310	253,482	66,763	26.3
Tires and tubes	631	76,957	11,195	14.5
Beer, wines, and liquors	5,986	1,171,509	150,605	12.9
Beer and ale	4,652	491,557	76,104	15.5
Wines and liquors	1,334	679,952	74,501	11.0
Chemicals and paints	1,593	216,696	40,175	18.5
Dyestuffs	57	20,601	3,190	15.5
Explosives	49	2,824	400	14.2
Industrial chemicals	259	80,704	11,078	13.7
Naval stores	23	11,528	1,088	9.4
Paints and varnishes	608	46,293	10,859	23.5
Paints with glass and/or wallpaper	311	28,675	7,907	27.6
All other	286	26,071	5,653	21.7
Clothing and furnishings	4,024	668,423	96,493	14.4
Clothing and furnishings (general line)	422	61,129	8,896	14.6
Men's and boys'	1,155	150,644	21,262	14.1
Women's and children's	1,056	216,766	33,620	15.5
Furs, dressed, and fur clothing	488	61,518	7,486	12.2
Millinery and millinery supplies	450	62,184	10,391	16.7
Shoes and other footwear	453	116,182	14,838	12.8
Coal and coke	520	270,338	27,728	10.3
Drugs (general line)	259	323,863	43,340	13.4
Service wholesalers (without liquor)	214	251,534	33,369	13.3
Service wholesalers (with liquor)	45	72,329	9,971	13.8

* For footnotes see p. 282

EXHIBIT 4 (*Continued*)

UNITED STATES SUMMARY OF WHOLESALE TRADE: 1939

Kind of Business	Number of Establishments *	Sales † (000 omitted)	Operating Expenses ‡	
			Amount (000 omitted)	Percentage of Sales
Drugs and drug sundries (specialty line)	1,242	$ 147,953	$ 38,519	26.0%
Proprietary medicines	391	42,176	8,066	19.1
Toiletries	367	45,392	17,278	38.1
Drug specialties and sundries	484	60,385	13,175	21.8
Dry goods (general line)	217	204,037	30,945	15.2
Dry goods (specialty lines)	2,911	479,593	62,984	13.1
Hosiery and lingerie	404	84,461	9,174	10.9
Notions	861	92,549	17,704	19.1
Piece goods:				
General line	46	13,769	2,094	15.2
Cotton	282	54,752	6,329	11.6
Silks, linen, rayon, and velvet	366	78,148	7,812	10.0
Woolen and worsted	348	89,046	9,631	10.8
Other	309	37,212	5,574	15.0
Other dry goods specialties	295	29,656	4,666	15.7
Electrical goods	3,036	777,874	129,223	16.6
Electrical merchandise (general line)	452	294,966	39,489	13.4
Apparatus and equipment	205	23,401	5,379	23.0
Wiring supplies and construction materials	942	124,991	21,899	17.5
Radios and equipment	658	111,278	21,178	19.0
Refrigerators and equipment (household)	159	118,018	20,116	17.0
All other	620	105,220	21,162	20.1
Farm products—raw materials	1,764	1,113,431	78,662	7.1
Cotton	133	181,956	12,577	6.9
Grains	373	452,464	24,120	5.3
Hides, skins, and raw furs	609	158,206	12,779	8.1
Horses and mules	26	6,992	329	4.7
Livestock	105	8,253	1,041	12.6
Tobacco (leaf)	144	62,189	9,124	14.7
Wool and mohair	153	179,634	11,876	6.6
All other	221	63,737	6,816	10.7
Farm products—consumer goods	10,072	2,003,035	267,302	13.3
Dairy products	1,977	465,744	108,347	23.3
Dairy and poultry products	725	240,254	20,762	8.6
Poultry and poultry products	1,527	238,693	21,974	9.2
Fruits and vegetables (fresh)	5,037	971,052	106,316	10.9
Fresh fruits only	776	81,964	9,329	11.4
All other	30	5,328	574	10.8
Farm supplies	1,424	305,451	40,831	13.4
Feed	762	126,788	13,926	11.0
Fertilizer	80	14,762	1,606	10.9
Seeds	407	100,348	19,081	19.0
All other	175	63,553	6,218	9.8

* For footnotes see p. 282.

Exhibit 4 (*Continued*)

United States Summary of Wholesale Trade: 1939

Kind of Business	Number of Establishments *	Sales † (000 omitted)	Operating Expenses ‡	
			Amount (000 omitted)	Percentage of Sales
Furniture and house furnishings	1,920	$ 319,289	$ 53,413	16.7%
China, glassware, and crockery	236	20,654	4,706	22.8
Floor coverings	411	133,462	18,239	13.7
Furniture (general line)	48	10,432	2,188	21.0
Furniture (household)	319	45,510	9,590	21.1
Furniture (office)	50	3,044	523	17.2
House furnishings (except as specified)	741	88,568	13,706	15.5
Musical instruments and sheet music	115	17,619	4,461	25.3
Groceries (general line)	2,748	1,302,579	125,321	9.6
Not sponsoring voluntary or cooperative groups	2,748	1,302,579	125,321	9.6
Groceries and foods (specialty lines)	10,205	1,568,483	231,239	14.7
Breakfast cereals	32	21,984	9,644	43.9
Canned foods	350	77,353	9,201	11.9
Coffee, tea, and spices	589	78,956	20,574	26.1
Coffee roasting and spice grinding	275	105,794	19,885	18.8
Confectionery	1,675	122,587	16,574	13.5
Fish and sea foods	1,104	126,640	25,584	20.2
Flour	315	44,385	5,140	11.6
Fruits and vegetables (frosted)	28	8,318	800	9.6
Meats and provisions	2,340	510,276	56,505	11.1
Other food and grocery specialties	3,497	472,190	67,332	14.3
Hardware	1,308	568,101	105,142	18.5
General line (with industrial department)	402	377,774	68,959	18.3
General line (without industrial department)	355	139,556	24,963	17.9
Specialty lines	551	50,771	11,220	22.1
Jewelry	1,571	199,831	36,263	18.1
Jewelry (general line)	194	62,071	10,635	17.1
Clocks and watches	140	38,503	7,156	18.6
Diamonds and other precious stones	302	26,030	2,694	10.3
All other	935	73,227	15,778	21.5
Lumber and construction materials	2,810	593,211	106,158	17.9
Builders' supplies (general line)	183	63,427	10,532	16.6
Lumber	836	194,664	27,838	14.3
Lumber and millwork	127	35,598	6,283	17.6
Millwork	266	57,491	12,783	22.2
Brick, tile, and terra cotta	132	16,898	2,717	16.1
Cement, lime, and plaster	98	21,048	3,361	16.0
Glass	280	31,927	9,395	29.4
All other	888	172,158	33,249	19.3
Machinery—equipment—supplies	9,580	1,230,010	251,886	20.5
Commercial equipment and supplies:				
Office machines and equipment	212	17,201	4,999	29.1
Restaurant and hotel supply houses	434	47,658	11,252	23.6

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* For footnotes see p. 282.

EXHIBIT 4 (*Continued*)

UNITED STATES SUMMARY OF WHOLESALE TRADE: 1939

Kind of Business	Number of Establishments *	Sales † (000 omitted)	Operating Expenses ‡	
			Amount (000 omitted)	Percentage of Sales
Garage and filling station equipment	169	$ 9,877	$ 2,537	25.7%
Soda fountain equipment and supplies	29	1,846	431	23.3
Store machines	46	2,900	476	16.4
Store fixtures and equipment	398	20,626	5,500	26.7
All other	339	30,366	6,473	21.3
Farm and dairy:				
Dairy equipment	106	19,479	3,562	18.3
Farm implements	20	2,944	643	21.8
Farm machinery and equipment	183	34,325	5,393	15.7
Industrial machinery, equipment, and supplies:				
Industrial (general line)	116	70,267	13,230	18.8
Belting, hose, and packing	211	18,837	4,576	24.3
Construction (except road building)	152	23,745	5,394	22.7
Road building	251	72,613	14,003	19.3
Machine tools	124	26,413	4,286	16.2
Mine and mill supplies	412	99,659	19,083	19.1
Oil well supply houses	895	179,059	18,757	10.5
Power plant and power transmission	88	10,399	1,989	19.1
Printing and lithographing (except paper)	151	10,909	3,494	32.0
Rope, cordage, and twine	53	12,717	1,804	14.2
Textile	74	8,387	1,912	22.8
Used machinery and equipment	286	15,163	4,107	27.1
All other	1,539	171,984	35,399	20.6
Professional equipment and supplies:				
Dental supply houses	328	33,732	9,655	28.6
Religious supply houses	92	8,308	2,278	27.4
School equipment and supplies	134	21,324	5,408	25.4
Surgical, medical, and hospital	368	50,254	13,225	26.3
All other	110	13,427	3,276	24.4
Service equipment and supplies:				
Barber and beauty supply houses	853	44,543	14,479	32.5
Laundry and dry cleaning	203	34,963	7,228	20.7
Tailors' supplies	64	2,809	565	20.1
Undertakers' supplies	107	4,545	1,277	28.1
Upholsterers' supplies	199	26,146	6,015	23.0
All other	597	34,482	8,236	23.9
Transportation equipment and supplies:				
Railroad	64	24,015	5,894	24.5
Marine	149	21,020	4,284	20.4
Other	24	3,068	766	25.0
Metals and metal work (except scrap)	972	429,819	56,243	13.1
Building metal work	133	13,164	2,699	20.5
Iron and steel products (general line)	92	75,628	14,721	19.5
Iron and steel products (semifinished)	56	11,387	2,432	21.4
Iron and steel products (flat)	193	64,495	13,020	20.2
Wire and wire products	60	5,915	1,359	23.0
Iron and steel finished products (N.E.C.)	283	53,709	11,437	21.3
Copper	37	49,250	2,043	4.1
All other	118	156,271	8,532	5.5
Paper and its products	2,851	541,302	97,368	18.0
Wrapping or coarse paper and products	1,656	291,926	50,853	17.4
Printing and writing paper	416	183,438	28,931	15.8

* For footnotes see p. 282.

EXHIBIT 4 (*Continued*)

UNITED STATES SUMMARY OF WHOLESALE TRADE: 1939

Kind of Business	Number of Establishments *	Sales † (000 omitted)	Operating Expenses ‡	
			Amount (000 omitted)	Percentage of Sales
Stationery and stationery supplies	503	$ 45,588	$ 10,871	23.8%
Wallpaper	276	20,350	6,713	33.0
Petroleum and its products	886	158,322	21,950	13.9
Plumbing and heating equipment and supplies	2,204	374,806	69,382	18.5
Plumbing and heating (general line)	675	185,102	32,118	17.4
Heating (including stoves and ranges)	361	35,880	8,533	23.8
Plumbing fixtures, equipment, and supplies	916	129,282	22,878	17.7
All other	252	24,542	5,853	23.8
Tobacco and products (except leaf)	2,390	1,066,923	52,660	4.9
Waste materials	6,007	615,495	93,541	15.2
Iron and steel scrap	1,851	298,252	40,036	13.4
Junk and scrap (general line)	1,888	92,876	17,231	18.6
Waste paper, rags, and rubber	1,118	132,686	24,794	18.7
Nonferrous metals	389	49,073	5,126	10.4
All other	761	42,608	6,354	14.9
All other products	5,127	677,574	113,894	16.8
Books, periodicals, and newspapers	856	166,848	30,412	18.2
Flowers and nursery stock	716	42,078	8,473	20.1
Forest products (except lumber)	554	42,404	8,141	19.2
General merchandise	106	61,551	9,381	15.2
Leather and shoe findings	934	112,748	14,515	12.9
Leather goods	137	12,691	2,511	19.8
Oils and greases (animal and vegetable)	64	41,416	3,520	8.5
Optical goods	565	41,530	14,936	36.0
Textiles and materials (other than dry goods)	286	32,831	5,115	15.6
Yarns	157	65,134	5,437	8.3
Miscellaneous kinds of business	752	58,343	11,453	19.6

* Number of places of business.

† Total receipts, excluding returns by customers or allowances to customers, but including sales taxes.

‡ Not including withdrawals by proprietor-owners of unincorporated businesses and not including imputed interest on investment.

§ Industrial distributors are distinguished from wholesale merchants by the fact that they sell primarily to industrial users rather than to retailers. The classification of wholesale merchants and industrial distributors by kinds of business cannot be readily reconciled with the classification in Part 1 according to types of operation. Many concerns are engaged both in wholesale business and in industrial business. From a marketing standpoint, the classification "Industrial Distributors" would normally be broader than that used by the Census.

Source: U.S. Bureau of the Census, *Census of Business: 1939, Wholesale Trade*, "Business-Size Groups and an Analysis of Operating Expenses" (Washington, D.C., U.S. Government Printing Office, 1941), Table 1, pp. 8–10.

EXHIBIT 5

COMPARATIVE RESULTS FOR RETAIL FOOD STORES OPERATED BY CO-OPERATIVE SOCIETIES AND BY PRIVATE INDEPENDENT MERCHANTS

(Net sales = 100%)

Items	Co-operatives[a] 1937	Privately Owned Independent Stores							
		Colorado[b] 1937	Dun & Bradstreet[c] 1936	The Progressive Grocer[d]—1934 (Profitable stores only)		Nebraska[e] 1929	Colorado[f] 1927	Iowa[g] 1927	Harvard[h] 1924
				Service Stores	Cash Stores				
Number of reports	42	63	1,051	25	23	211	35	61	545
Typical net sales (in thousands)	$50	$46	$34	$49 [i]	$69 [i]	$40 [j]	$70 [j]	$42	$73
Gross margin	18.5%	18.5%[k]	18.5%[k]	19.6%[k]	17.6%[k]	18.5%[k]	19.45%	18.56%	19.8%
Salaries and wages	9.6	9.5	10.5	10.4	8.0	10.28	10.75	10.50	10.9
Tenancy, heat, light, and power	2.55	2.0	2.2	2.1	2.1	2.1	2.0	2.46	1.6
Advertising	0.35	0.6	0.5	0.6	1.1	0.45	0.5	0.30	0.35
Other expense	4.1	3.5	3.2	3.6	3.0	3.52	3.8	2.92	4.05
Total expense before interest	16.6%	15.6%	16.4%	16.7%	14.2%	16.35%	17.05%	16.18%	16.9%
Interest	1.0	[l]	[l]	0.0[m]	0.2[m]	0.75	1.25	0.96	1.1
Total expense including interest	17.6%	[l]	[l]	16.7%	14.4%	17.1%	18.3 %	17.14%	18.0%
Net profit or loss	0.9	2.9 [kn]	2.1 [kn]	2.9 [kn]	3.2 [kn]	1.4 [k]	1.15	1.42	1.8
Rate of stock-turn	12.8	13.7	15.3	19.2	10.0	11.75	12.5	11.86	10.0

[a] Common figures, from Table 1, p. 5.

[b] Typical figures, from William H. Slaton, *Cost of Doing Business Survey of Retail Grocery Stores in Colorado*, Business Bulletin No. 38 (Boulder, University of Colorado, Bureau of Business and Government Research, 1938), p. 7.

[c] Typical figures, for grocery and meat stores, from Survey No. 10, *1937 Retail Survey* (New York, Dun & Bradstreet, Inc., 1937).

[d] Average figures, based on dollar aggregates, for combination stores, from "Operating Expenses of 110 Selected Food Stores" (New York, *The Progressive Grocer*, 1935), pp. 19–30.

[e] Common figures, from *Operating Expenses of Retail Grocery Stores in Nebraska, 1929*, Nebraska Studies in Business No. 27 (Lincoln, Extension Division, University of Nebraska, 1930), p. 25.

[f] Typical figures, from *Operating Expenses and Profit of Retail Grocery and General Merchandise Stores in Colorado in 1927*, Business Bulletin No. 19 (Boulder, University of Colorado, Bureau of Business and Government Research, 1928), pp. 7, 9.

[g] Typical figures, from William F. Bristol, *Operating Costs of Service Grocery Stores in Iowa for the Year 1927*, Iowa Studies in Business No. VI (Iowa City, State University of Iowa, Bureau of Business Research, 1930), pp. 12–13.

[h] Common figures, from *Operating Expenses in Retail Grocery Stores in 1924*, Harvard Business School, Bureau of Business Research, Bulletin No. 52, 1925, p. 23.

[i] It is not stated in the source material whether or not the sales figure is net.

[j] Estimate of the Harvard Bureau of Business Research and based on published summarized frequency distribution.

[k] Cash discounts are not deducted from purchases, or the treatment is not described. Gross margin and net profit possibly are understated owing to the inclusion of cash discounts in other income by some or all stores.

[l] Data not available.

[m] Interest paid only.

[n] Net profit is, or probably is, overstated in comparison with the figures in other columns owing to the fact that an adequate figure for interest was not available.

Source: Harvard Business School, Bureau of Business Research, Bulletin No. 108, 1939, *Operating Results of Consumer Cooperatives in the United States in 1937* by Carl N. Schmalz, Table 3, p. 9.

EXHIBIT 6

AVERAGE COSTS AND PROFITS OF DRUG STORES, 1943–1946

(Net sales = 100%)

	1943	1944	1945	1946
Number of stores	1,244	1,056	1,037	1,096
Sales per store	$46,916	$52,297	$62,038	$69,422
Cost of goods sold	67.4%	67.5%	67.0%	67.7%
Gross margin	32.6	32.5	33.0	32.3
Proprietor's or manager's salary	8.0	8.0	7.0	6.5
Employees' wages	6.0	7.0	8.5	9.0
Rent	3.0	2.5	3.0	2.8
Heat	0.5	0.4	0.4	0.4
Light and power	0.6	0.5	0.6	0.7
Taxes * and licenses	0.6	0.8	0.8	0.6
Insurance	0.3	0.3	0.3	0.4
Interest paid	0.2	0.1	0.1	0.1
Repairs	0.2	0.3	0.4	0.3
Delivery	0.2	0.1	0.1	0.2
Advertising	0.4	0.5	0.5	0.6
Miscellaneous	1.7	1.3	1.1	1.3
Depreciation †	0.6	0.5	0.4	0.5
Bad debt losses	0.1	0.1	0.1	0.1
Telephone	0.3	0.3	0.2	0.2
Total expenses	22.7%	22.7%	23.5%	23.7%
Net profit	9.9%	9.8%	9.5%	8.6%
Average inventory at cost	$ 6,363	$ 7,926	$ 9,459	$10,487
Stock-turn (times per year)	5.0	4.5	4.4	4.5

* Except on building, income, and profit.

† Except on buildings.

Source: Adapted from the annual *Lilly Digest of Statements of Retail Drug Stores* (Indianapolis, Eli Lilly and Company), 13th and 14th eds., 1945 and 1946, Table 2, p. 8, and 15th ed., 1947, Table 1, p. 7. Reprinted by permission.

EXHIBIT 7

OPERATING RESULTS FOR DRUG CHAINS IN THE UNITED STATES, 1938

(Net sales = 100%)

Number of chains	23
Number of stores operated	1,766
Aggregate sales	$213,288,456
Average sales per store	$120,774
Gross margin *	31.94%
Pay roll:	
Officers and executives †	0.75
Store employees	12.66
All employees	16.5
Rent:	
Store	6.01
Warehouse and office	0.33
Total	6.34
Advertising	2.35
Taxes: ‡	
Federal	1.1
State and local	2.33
Total taxes	3.33
Total expense	28.49
Net margin §	3.45

* Reports from 14 companies operating 1,063 stores with total sales of $139,792,407.

† Reports from 20 companies operating 1,286 stores; sales volume $163,428,638.

‡ Reports from 17 companies operating 1,236 stores with total sales of $157,425,675.

§ Before deductions for heat, light, power, water, and transportation.

Source: Adapted from "National Association Compiles Statistics on Drug Store Operating Costs," *Chain Store Age*, June, 1939 (Druggist ed.), pp. 33–34. Reprinted by permission.

EXHIBIT 8

TYPICAL OPERATING RESULTS FOR 510 INDEPENDENT FURNITURE RETAILERS, 1939, BY CENSUS AREA AND PROFIT STATUS

(Net sales = 100%)

	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Moun-tain	Pacific	All Firms	Profit-able Firms	Range of Usual Profitable Experience
Number of firms	37	74	113	35	61	27	50	35	78	510	367	
Typical net sales (in thousands)	$45.1	$36.2	$40.3	$37.6	$35.8	$37.2	$37.3	$39.5	$41.3	$37.7		
Cost of goods sold	62.6%	60.7%	62.9%	65.6%	56.3%	59.7%	59.0%	64.2%	63.1%	61.9%	61.2%	
Gross margin	37.4	39.3	37.1	34.4	43.7	40.3	41.0	35.8	36.9	38.1	38.8	34.9%–45.4%
Salaries, owners and officers	10.4	9.1	8.8	9.8	8.6	7.5	9.5	9.1	9.1	8.9	8.2	5.2 –10.7
Wages, all other employees	9.6	10.0	9.9	7.9	9.8	10.3	9.8	9.9	9.6	9.8	9.3	5.7 –12.1
Occupancy	5.6	5.5	5.4	4.9	3.8	3.4	4.3	4.9	4.3	5.1	4.8	2.9 – 6.2
Advertising	1.1	2.5	1.9	2.0	1.0	1.5	1.4	1.4	1.7	1.6	1.5	0.8 – 2.5
Bad debts	1.2	1.4	0.6	0.6	1.5	2.4	1.3	1.0	0.6	1.0	1.0	0.4 – 1.7
All other expense	7.3	7.8	7.7	6.8	8.4	7.8	7.1	5.7	6.9	7.3	6.9	3.9 – 9.5
Total expense	35.2%	36.3%	34.3%	32.0%	33.1%	32.9%	33.4%	32.0%	32.2%	33.7%	31.7%	25.7%–36.0%
Net profit	2.2%	3.0%	2.8%	2.4%	10.6%	7.4%	7.6%	3.8%	4.7%	4.4%	7.1%	3.4%–12.7%
Stock-turn (times per year)	2.6	2.4	2.8	2.3	3.3	3.1	2.7	2.5	2.8	2.7	2.8	2.0 – 4.1

Source: Adapted from Dun & Bradstreet, Inc., *1940 Retailers' Operating Cost Survey*, No. 30, *Furniture Stores* (New York, 1940), pp. 103, 107. Reprinted by permission.

EXHIBIT 9

AVERAGE OPERATING RATIOS FOR JEWELRY STORES: 1938

(Net sales = 100%)

	All Stores Reporting	Volume of Sales			
		Less than $20,000	$20,000–$49,000	$50,000–$99,000	$100,000 and Over
Number reporting	81	22	27	13	19
Merchandise departments:					
Typical merchandise sales	$41,800	$8,300	$39,800	$76,100	$181,700
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of merchandise sold	57.9	58.5	54.4	56.4	57.5
Gross margin	42.1	41.5	45.6	43.6	42.5
Operating expenses:					
Total salaries and wages	20.4	22.8	23.5	17.9	18.4
Rent	5.7	5.8	6.3	5.3	5.5
Advertising	3.1	2.1	3.2	3.1	3.2
Store and office supplies	1.0	1.0	1.1	1.0	0.9
Heat, light, power and water	1.2	1.4	1.3	1.0	0.8
Taxes	1.6	1.5	1.1	1.7	1.6
Insurance	0.9	0.8	1.3	1.2	0.8
Depreciation	0.8	1.1	0.8	0.6	0.8
Losses from bad debts	0.5	0.5	0.5	0.5	0.4
All other expenses	3.0	2.6	3.1	2.7	4.0
Total expenses before interest	38.2%	39.6%	42.2%	35.0%	36.4%
Interest	2.8	3.7	3.0	2.6	2.3
Total operating expenses	41.0%	43.3%	45.2%	37.6%	38.7%
Net profit or loss	1.1%	−1.8%	0.4%	6.0%	3.8%
Rate of stock-turn (times per year)	0.9	0.8	0.9	1.1	1.1
Repairing department:					
Typical repairing receipts	$ 6,300	$ 2,300	$ 5,600	$ 7,500	$ 19,400
Total expense	88.4%	84.6%	91.0%	91.1%	90.4%
Net profit	11.6	15.4	9.0	8.9	9.6

Source: Compiled by the American National Retail Jewelers' Association and reported in U.S. Bureau of Foreign and Domestic Commerce, Department of Commerce, Inquiry Reference Service, ***Jewelry Stores—Operating Ratios***, Release No. 2–13600, p. 3.

EXHIBIT 10

TYPICAL OPERATING RESULTS FOR 391 INDEPENDENT ELECTRIC AND GAS HOUSEHOLD APPLIANCE FIRMS, 1939, BY CENSUS AREA AND PROFIT STATUS

(Net sales = 100%)

	All Stores by Census Area									All Firms	Profitable Firms
	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific		
Number of firms	17	70	115	45	24	8	27	14	71	391	235
Typical net sales (in thousands)	$33.4	$25.0	$23.2	$24.6	$30.3	$20.9	$20.2	$18.8	$27.8	$24.4	
Cost of goods sold	66.5%	65.6%	65.0%	65.2%	64.4%	67.5%	62.3%	62.8%	62.8%	64.7%	62.6%
Gross margin	33.5	34.4	35.0	34.8	35.6	32.5	37.7	37.2	37.2	35.3	37.4
Salaries, owners and officers	9.7	10.2	10.5	9.1	8.1	*	11.8	10.7	10.6	10.1	9.5
Wages, all other employees	9.6	10.9	10.1	10.9	12.5	*	10.6	8.6	12.8	10.7	9.7
Occupancy	3.3	3.4	3.9	4.0	2.2	*	3.0	4.0	3.4	3.5	3.1
Advertising	1.8	1.4	1.8	1.1	0.7	*	1.1	1.5	1.3	1.5	1.2
Bad debts	0.5	0.5	0.6	0.6	0.5	*	0.9	0.7	0.6	0.5	0.5
All other expense	6.3	6.2	6.3	4.4	7.7	*	7.0	8.5	7.9	6.5	6.4
Total expense	31.2%	32.6%	33.2%	30.1%	31.7%	31.3%	34.4%	34.0%	36.6%	32.8%	30.4%
Net profit	2.3%	1.8%	1.8%	4.7%	3.9%	1.2%	3.3%	3.2%	0.6%	2.5%	7.0%
Stock-turn (times per year)	5.3	4.6	4.6	4.0	5.6	6.3	4.3	4.9	4.4	4.6	4.9

* Sample too small to yield reliable averages for individual expense items.

Source: Adapted from Dun & Bradstreet, Inc., *1940 Retailers' Operating Cost Survey*, No. 28, *Electric and Gas Household Appliance Stores* (New York, 1940), pp. 95, 99. Reprinted by permission.

EXHIBIT 11

TYPICAL OPERATING RESULTS FOR 1,000 INDEPENDENT GROCERY-AND-MEAT RETAILERS, 1939, BY CENSUS AREA AND PROFIT STATUS

(Net sales = 100%)

	All Firms by Census Area									All Firms	Profitable Firms
	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific		
Number of firms	82	148	250	171	78	40	82	73	76	1,000	700
Typical net sales (in thousands)	$43.5	$28.4	$31.5	$29.0	$28.3	$30.6	$31.5	$33.9	$38.2	$31.4	
Cost of goods sold	79.9%	81.5%	81.0%	81.1%	80.0%	80.5%	82.1%	80.0%	79.7%	80.8%	80.0%
Gross margin	20.1	18.5	19.0	18.9	20.0	19.5	17.9	20.0	20.3	19.2	20.0
Salaries, owners and officers	5.3	5.8	5.7	5.8	6.2	6.4	5.5	5.6	5.1	5.7	5.5
Wages, all other employees	6.6	5.0	5.9	5.1	5.3	4.3	4.9	5.0	6.1	5.6	5.4
Occupancy	2.3	2.3	2.3	2.2	1.8	2.3	2.2	2.0	2.1	2.3	2.3
Advertising	0.5	0.4	0.6	0.8	0.4	0.3	0.7	0.5	0.5	0.6	0.5
Bad debts	0.4	0.3	0.5	0.5	0.8	0.9	0.6	0.6	0.5	0.5	0.5
All other expense	3.2	2.5	2.3	2.8	2.7	2.6	2.2	3.5	3.0	2.6	2.3
Total expense	18.3%	16.3%	17.3%	17.2%	17.2%	16.8%	16.1%	17.2%	17.3%	17.3%	16.5%
Net profit	1.8%	2.2%	1.7%	1.7%	2.8%	2.7%	1.8%	2.8%	3.0%	1.9%	3.5%
Stock-turn (times per year)	11.9	13.6	15.1	12.7	11.9	15.4	14.2	12.9	11.6	13.5	13.8

Source: Adapted from Dun & Bradstreet, Inc., *1940 Retailers' Operating Cost Survey*, No. 7, *Grocery and Meat Stores* (New York, 1940), pp. 17, 22. Reprinted by permission.

EXHIBIT 12

OPERATING PERCENTAGES REPORTED BY CERTAIN FOOD CHAINS, 1946, CLASSIFIED BY SALES VOLUME

	Average Figures *				Median Figures †			
	All Chains	Under $5,000,000	$5,000,000–$25,000,000	$25,000,000 and Over	All Chains	Under $5,000,000	$5,000,000–$25,000,000	$25,000,000 and Over
Net sales	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Cost of goods sold	81.02	81.23	80.46	81.42	81.18	81.25	80.62	81.52
Gross margin	18.98%	18.77%	19.54%	18.58%	18.82%	18.75%	19.38%	18.48%
Expenses:								
Store	10.69%	10.73%	11.21%	10.05%	10.57%	10.57%	11.01%	9.88%
Warehouse	1.09	1.06	1.01	1.18	1.03	0.81	0.81	1.13
Transportation	0.79	0.50	0.83	1.01	0.80	0.47	0.75	1.01
General and overhead	2.82	2.63	3.10	2.71	2.83	2.40	2.87	2.41
Total operating expense	15.20%	14.86%	15.79%	14.88%	14.84%	14.76%	15.05%	14.73%
Net operating profit after Federal income tax	2.34	2.42	2.32	2.29	2.32	2.64	2.31	2.23

* Editors' Note: Total operating expense figures may not represent the total of the individual expense figures since some chains do not operate warehouses and would have neither warehouse nor transportation expense.

† Editors' Note: Since median figures for the various items are set individually, the sum of the various operating expenses may not equal the respective total operating expense figures.

Source: National Association of Food Chains. Unpublished data.

EXHIBIT 13

TYPICAL OPERATING RESULTS FOR 791 MOTOR VEHICLE DEALERS, 1939, BY CENSUS AREA AND PROFIT STATUS

(Net sales = 100%)

	All Dealers by Census Area									All Firms	Profitable Firms
	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific		
Number of firms	43	109	187	110	58	17	83	80	104	791	515
Typical net sales (in thousands)	$158.2	$146.7	$121.2	$98.5	$218.4	$153.4	$134.0	$116.9	$147.0	$136.5	
Cost of goods sold	82.3%	83.9%	83.2%	82.9%	83.8%	83.3%	82.2%	80.3%	82.1%	82.9%	81.8%
Gross margin	17.7	16.1	16.8	17.1	16.2	16.7	17.8	19.7	17.9	17.1	18.2
Salaries, owners and officers	2.6	2.1	2.6	2.7	2.1	2.0	2.5	3.1	2.5	2.5	2.2
Wages, all other employees	6.0	6.0	6.4	6.0	5.6	6.0	6.5	7.3	7.4	6.5	6.3
Occupancy	2.2	1.9	1.6	1.8	1.2	1.2	1.2	2.0	1.8	1.5	1.5
Advertising	0.5	0.6	0.7	0.5	0.6	0.4	0.7	0.7	0.7	0.6	0.6
Bad debts	0.4	0.3	0.3	0.4	0.3	0.4	0.5	0.6	0.3	0.3	0.3
All other expense	5.4	4.2	3.9	4.6	4.3	4.2	4.7	4.4	4.9	4.5	4.1
Total expense	17.1%	15.1%	15.5%	16.0%	14.1%	14.2%	16.1%	18.1%	17.6%	15.9%	15.0%
Net profit	3.6%	17.3%	13.6%	21.1%	26.8%	19.1%	15.8%	8.6%	10.1%	1.2%	3.2%
Stock-turn (times per year)	6.8	9.1	7.0	6.3	10.1	9.0	6.6	6.7	8.5	8.3	8.5

Source: Adapted from Dun & Bradstreet, Inc., *1940 Retailers' Operating Cost Survey*, No. 27, *Motor Vehicle Dealers* (New York, 1940), pp. 91, 94. Reprinted by permission.

EXHIBIT 14

AVERAGE OPERATING RESULTS FOR ALL REPORTING RETAIL HARDWARE STORES IN THE UNITED STATES, 1939–1946

(Net sales = 100%)

	1939	1940	1941	1942	1943 [a]	1944 [a]	1945	1946
Number of stores	1,197	1,164	1,008	1,039	1,034	1,057	1,015	1,103
Average sales per store	$50,513	$52,007	$59,875	$67,314	$52,406	$57,655	$65,010	$94,270
Cost of goods sold	72.65%	73.18%	73.23%	71.71%	69.82%	70.36%	70.75%	72.10%
Gross margin	27.35	26.82	26.77	28.29	30.18	29.64	29.25	27.90
Salaries:								
Management, buying	2.73	2.66	2.44	2.43	6.17	5.92	6.25	5.25
Selling	9.66	9.38	8.40	7.99	4.75	4.40		
Other	1.79	1.69	1.49	1.52	1.54	1.41	6.80	6.90
Other including delivery	.....	.....	.....	.....	1.08	1.17		
Total salaries and wages	14.18% [g]	13.73% [g]	12.33% [g]	11.94% [g]	13.54%	12.90%	13.05%	12.15%
Rent [b]	3.26	3.08	2.69	2.50	2.21	1.95	2.00	1.55
Repairs	0.21	0.21	0.22	0.20	0.20	0.24	0.20	0.20
Heat, light, power	0.78	0.79	0.69	0.63	0.57	0.53	0.55	0.40
Advertising	0.98	0.96	0.80	0.57	0.47	0.47	0.55	0.60
Office supplies and postage	0.50	0.39	0.35	0.32	0.29	0.25	0.25	0.25
Donations	0.12	0.13	0.13	0.13	0.14	0.17	0.15	0.10
Store supplies	0.23	0.24	0.24	0.22	0.21	0.20		
Telephone and telegraph	0.29	0.29	0.26	0.25	0.23	0.22	0.25	0.20
Losses on notes and accounts [c]	0.57	0.42	0.44	0.30	0.13	0.07	0.20	0.20
Delivery expense	1.32 [h]	1.38 [h]	1.27 [h]	1.15 [h]	0.42 [i]	0.44 [i]	0.45 [i]	0.40 [i]
Depreciation:								
Delivery equipment	0.30	0.30	0.28	0.25	0.22	0.20	0.10	0.10
Furniture, fixtures, tools	0.36	0.34	0.30	0.28	0.27	0.25	0.25	0.20

Insurance [d]	0.59	0.56	0.50	0.48	0.43	0.39	0.40	0.35
Taxes [d]	0.99	0.96	0.85	0.87	0.69	0.57	0.60	0.50
Interest on borrowed money	0.48	0.44	0.42	0.34	0.24	0.21	0.10	0.05
Unclassified	0.63	0.64	0.54	0.55	0.49	0.48	0.70 [j]	0.75 [j]
Total expense	25.79%	24.86%	22.31%	20.98%	20.75%	19.54%	19.80%	18.00%
Net operating profit	1.56	1.96	4.46	7.31	9.43	10.10	9.45	9.90
Cash discounts and interest received	1.33	1.33	1.45	1.27	1.25	1.34	1.45	1.40
Net profit	2.89	3.29	5.91	8.58	10.68	11.44	10.90	11.30
Salary per owner	$ 1,966	$ 1,962	$ 2,022	$ 2,250	$ 2,322	$ 2,411	$ 2,590	$ 2,980
Salary per clerk	1,047	1,035	1,105	1,190	1,266	1,362		1,735
Salary per office employee	760	743	759	873	1,152	1,248	1,475	1,530
Salary per other employee	....	....	....	....	1,050	1,165		1,445
Sales per actual salesman	14,303	14,905	17,396	20,224				
Sales per person employed	9,911 [g]	10,256 [g]	11,953 [g]	13,640 [g]	12,998 [g]	14,271 [g]	15,665 [g]	18,585 [g]
Credit sales	50%	51%	49%	42%	34%	31%	29%	29%
Days' credit [e]	91	90	76	49	49	48		
Capital-turn [f]	2.09	2.17	2.34	2.37	2.14	2.26	2.34	2.91
Stock-turn (times per year)	2.24	2.30	2.51	2.71	2.80	3.23	3.42	3.53

[a] Median.

[b] Including taxes, insurance, and depreciation on buildings when owned, and real estate indebtedness.

[c] Including collection expenses.

[d] Excluding those on real estate.

[e] Days' credit business on books at end of year.

[f] Real estate not included in capital.

[g] Excluding delivery and shopmen.

[h] Including wages of deliverymen.

[i] Excluding wages of deliverymen.

[j] Including store supplies.

Source: Adapted from the annual *Hardware Store Survey* compiled by the National Retail Hardware Association and published in *Hardware Retailer*, 1945 figures in the July issue, 1939–1944 and 1946 figures in the June issues. Reprinted by permission.

EXHIBIT 15

EXTENT TO WHICH INDEPENDENT RETAIL FIRMS USED BUYING AGENCIES, 1939, BY TYPE OF RETAILER, TYPE OF AGENCY, AND PROPORTION OF PURCHASES

Type of Retailer	Survey Number	Number of Firms	Voluntary Groups		Retailer-owned Cooperatives		Other Buying Groups		% of Firms Using More than One Type	% of Firms Not Reporting *
			% of Firms	% of Purchases	% of Firms	% of Purchases	% of Firms	% of Purchases		
I. Food, beverage, and restaurant group:										
Alcoholic beverages	1	69	20%	100%	1%	.....	9%	100%	....	70%
Bakery shops	2	109	15	100	5	80%	8	25	7%	80
Confectionery	3	102	19	100	5	25	10	75	8	75
Dairy and poultry products	4	32	9	100	6	75	9	75	..	78
Drinking places, taverns, and bars	5	136	22	100	6	15	12	100	9	69
Grocery	6	291	32	85	13	50	16	42	15	54
Grocery and meat	7	1,000	34	75	12	50	18	40	18	54
Grocery with filling stations	8	198	39	100	7	25	17	20	15	52
Meat	9	138	10	100	1	...	5	60	4	88
Restaurants, eating places	10	222	16	90	9	37	10	20	14	78
II. General merchandise and farmers' supply group:										
Country general stores	11	1,100	34	80	7	45	14	30	14	59
Dry goods and general merchandise	12	564	18	100	3	10	7	20	4	77
Farm implement	13	147	19	100	1	...	3	10	5	81
Farmers' supply	14	334	19	90	6	27	10	40	11	77
Limited price variety	15	320	41	75	5	50	19	25	20	55
III. Apparel group:										
Custom tailors	16	25								
Family clothing	17	298	16	100	4	27	8	30	5	77
Fur	18	32	6	100	3	..	3	...	..	88

Lingerie, hosiery, millinery, accessory	19	75	11	100	3	...	3	...	3	83
Men's clothing	20	320	7	100	3	26	3	80	2	89
Men's furnishings	21	75	5	100	0	...	4	100	..	91
Shoes	22	300	12	100	1	75	2	100	..	85
Women's ready-to-wear	23	333								
IV. Automotive group:										
Automotive accessory and parts	24	268	30	97	5	90	15	10	16	66
Filling stations	25	1,145	31	100	7	44	13	10	14	64
Garages (with repairing)	26	161	27	100	4	23	11	20	12	71
Motor vehicle	27	791								
V. Furniture and household group:										
Electric and gas household appliance	28	391	19	100	1	10	5	63	4	79
Floor coverings	29	28	0	...	4	...	4	...	4	96
Furniture	30	510	9	100	1	100	5	80	2	85
Furniture and undertaking	31	97	15	100	1	...	1	...	..	82
House furnishings	32	92	13	100	1	...	3	...	..	84
Radios	33	30	20	100	3	...	3	...	7	80
VI. Building materials and hardware group:										
Hardware	34	555	26	100	8	40	8	25	8	67
Paint, wallpaper, and glass	35	148	22	100	1	...	8	17	5	74
Hardware and farm implements	36	113	24	99	13	25	8	15	10	65
Hardware and furniture	37	98	23	100	8	11	6	26	9	71
Lumber and building material	38	793	16	100	5	15	6	40	5	78
VII. All other retail stores:										
Book	39	73								
Cigar stores and stands	40	43	26	90	7	...	9	10	12	70
Coal and other fuel	41	158	9	100	1	...	4	100	2	87
Drug	42	587	28	98	12	30	11	30	15	64
Gift, novelty and souvenir	43	79	8	100	1	...	4	40	4	91
Jewelry	44	306	12	100	..	...	3	20	2	87
Monument	45	60	20	100	2	...	2	...	2	78
Musical instruments	46	32	9	100	0	...	6	...	..	85
Nurseries and florists	47	108	11	90	1	...	10	20	7	84
Office equipment and supplies	48	117								
Sporting goods	49	45	16	100	0	...	4	10	4	84
Stationery	50	115	8	100	1	...	6	40	2	87

* Most of the firms not specifying any buying group may be presumed to have made their purchases independently.

Source: Adapted from Dun & Bradstreet, Inc., *1940 Retailers' Operating Cost Survey*, Nos. 1–50 (New York, 1940), Schedule I of each study. Reprinted by permission.

SELECTED DISTRIBUTION DEFINED AND DESCRIBED

BY JAMES DACON SCOTT

Selected retail distribution is that type of distribution which limits the sale of a product to chosen retailers in each community.[1] It is to be contrasted with nonselected retail distribution, the purpose of which is to attain density of distribution. In the extreme case of selected distribution, the seller has only one retail representative in a given community and this seller is known as an exclusive agent. Where nonexclusive sales rights are given to more than one retailer[2] per territory, but where the number appointed is restricted, "joint agents" are used. All gradations of limitation in number may be found, from one to a number so large as to approach the density of distribution attained under a policy of nonselected retail distribution.

It should be noted that although nonselected distribution involves selling to any and all retailers of good credit standing who will stock the product, density of distribution attained will vary among companies and products. Analysis of data for drug stores audited for the Nielson Food and Drug Index[3] discloses,

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Source: *Advertising Programs for Products with Selected Distribution* (Harvard Business School, Division of Research, Business Research Studies No. 26, 1942), Chap. II, pp. 5–17. Reprinted by permission.

[1] The Committee on Definitions of the National Association of Marketing Teachers defined selective selling as follows: "*Selective Selling.* The policy of selling to a limited number of accounts in any geographical area." ["Definitions of Marketing Terms, Consolidated Report of the Committee on Definitions," *The National Marketing Review,* Vol. 1, No. 2 (Fall, 1935), p. 163.]

Professor Copeland defined selected distribution as follows in his *Principles of Merchandising:* "A manufacturer . . . utilizes selected retail distribution by choosing one or at most a few stores in each city to which to sell his product. In small cities he generally sells to not more than one retail store." [Melvin T. Copeland, *Principles of Merchandising* (Chicago, Shaw, 1924), p. 118.]

In my opinion, this definition sets an upper limit on the policy of selected distribution which is too low. Thus Company 5, a manufacturer of mechanical refrigerators, reported that its products were sold through selected retail outlets in each community. This company used a formula of one retail outlet per 25,000 population as a rough guide for dealer coverage. The company reported that on the average one retailer was appointed in cities of 10,000 population; four retailers were appointed in cities of 100,000 population; 40 dealers were appointed in cities of 1,000,000 population. Also, the company indicated that it had 160 dealers in Chicago and 300 dealers in New York City. Because of this case and other similar examples encountered in this study, it was decided not to set a precise numerical upper limit to the number of retailers that may be appointed per community under a policy of selected distribution.

[2] The term "retailer" is defined as follows by the Committee on Definitions of the National Association of Marketing Teachers: "A middleman who sells mainly to the ultimate consumer. He may sell to institutions but most of his sales are made to individuals or household consumers. He usually sells in small lots." ("Definitions of Marketing Terms," p. 160.)

The retailers chosen to sell the brand of a manufacturer following the policy of selected distribution are commonly referred to, in the trade, as "dealers." In this study, therefore, the term "dealer" is used as a simplified version of the more exact term "retail dealer."

[3] The Nielsen Food and Drug Index is based upon store audits covering some 3,200 retail stores located in 700 cities. These stores are selected in order to provide a true sample or cross-section of the entire country. The stores are proportioned by territories, cities, city sizes, store types, store sizes, class of neighborhood, store ownership, and consumer incomes. (F. K. Leisch, "Profits from Practical Marketing Research," American Management Association, Consumer and Industrial Marketing Series, CM 24, p. 7.)

for example, that 12 firms producing toothpaste secured retail coverage of from 71% to 98% of the drug stores, while 7 firms producing tooth powder had retail coverage of from 51% to 97% of the stores surveyed. In many cases it may not prove possible to achieve density of distribution and hence the result may be a forced selected distribution.

In this study the generalizations explaining variations in advertising practice do not apply to forced selected distribution when nonselected distribution is the wise choice for the manufacturer's product. It is believed that the generalizations may apply to cases of forced selected distribution when selected distribution would have been a wise choice. It should be emphasized, however, that the present analysis is based chiefly on the experience of firms which definitely planned to restrict the number of retail outlets for their goods.

Exclusive Agency Distribution

As indicated in the preceding section, the practice of granting an exclusive agency to one retailer in a community, or larger geographical area, represents the extreme degree of limitation in number of retail outlets appointed under a policy of selected retail distribution.

Definition

An exclusive agency consists of an agreement between the manufacturer, or his wholesale distributor, and the retailer whereby the retailer is granted the sole right to sell merchandise bearing the manufacturer's brand within a described geographical area.[1]

Exclusive Sales Rights Granted

The agreement of the manufacturer to sell a specified brand through only one retail store in each territory constitutes a major characteristic of the exclusive agency plan. As defined, the term "exclusive agency" does not include the practice of designating two or more retailers in a given territory as exclusive agents. While this is a form of selected distribution, it is not exclusive agency distribution.[2]

In granting exclusive agencies, large manufacturers usually reserve the right to sell directly to special customers, such as the United States Government, states, and county and municipal bodies. Likewise some companies reserve certain classes of trade as house accounts, such as manufacturers purchasing for use in their own business and not for resale.[3]

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[1] The Committee on Definitions of the National Association of Marketing Teachers defined exclusive agency selling as follows: "That form of selective selling whereby sales to any one type of buyer are made through one dealer or distributor in each geographical area usually on a contractual basis." ("Definitions of Marketing Terms," p. 152.)

In *The Exclusive Agency* the following definition appeared: "Any agreement to sell within a certain territory a commodity or service through only one company or individual constitutes an unlimited or single exclusive agency." [New York University Bureau of Business Research, *The Exclusive Agency* (New York, New York University, 1923), p. 1.]

[2] See footnote 3, p. 302.

[3] *The Exclusive Agency*, p. 6.

DEFINITION OF TERRITORY

An important feature of the exclusive agency agreement is the definition of the territory within which the retailer is to have exclusive rights. This territory may include the area within the corporate limits of a city, a retail trading area, a section of a large city, or some other geographical area. The common practice among the companies covered was to make the city the smallest territorial unit in which exclusive sales rights were granted.

In a large city a company might grant one dealer the exclusive sales rights to a specified section of the community. If this were done, the result would be several retail representatives, each with exclusive sales rights to a specified section of the city. The case of the Tonebilt Radio Company, manufacturer of radio receiving sets designed to be sold at retail from $160 to $300, illustrates the application of this practice as of 1930.[1]

Tonebilt Radio Company sold directly to retailers, giving them exclusive territories. In the more concentrated markets the company had several representatives, each with exclusive sales rights to a territory consisting of a section of a city. Each dealer was expected to employ salesmen to call at every residence in his territory. The larger part of the sales were made in this way. The stores were intended to be primarily sales headquarters and stockrooms.

A company may follow the alternative practice of making a city the exclusive territory of one retailer. As an example of this policy the Lockwood Tire Company may be cited. This company, manufacturing a line of high-quality tires and tubes, distributed its products through 2,500 dealers, each having a city or town as exclusive territory.[2]

Instead of limiting the territory of the exclusive agent to the corporate limits of the city, a manufacturer may extend the territory to cover the city and the surrounding small towns included in the retail trading area. The Randolph Eaton Company, manufacturer of electric refrigerators, provides an example of this practice. This company made its distributors responsible for the choice of retail dealers, as to both type and number. Except for large cities, the distributors gave one dealer the exclusive franchise for the city and surrounding territory.[3]

Although a company may divide a city into several sales territories, giving one dealer exclusive sales rights in each territory, Tonebilt Radio Company was the only organization encountered in this study which followed this practice. Instead, the general practice among the companies covered was to make the city the smallest geographical unit in which exclusive sales rights were granted. When a market was too large for one selling representative to handle adequately, the exclusive agency plan was dropped, and nonexclusive selling rights were given to several selling representatives. This practice is illustrated by the following examples.

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[1] Edmund P. Learned, *Problems in Marketing* (New York, McGraw-Hill, 1936), pp. 129–131.

[2] Harry R. Tosdal, *Problems in Sales Management* (3d ed., New York, McGraw-Hill, 1931), p. 281.

[3] Learned, *op. cit.*, pp. 183–184.

According to the Federal Trade Commission, in 1939 the several selling divisions of both General Motors Sales Corporation and Chrysler Corporation usually designated metropolitan areas as nonexclusive territories.[1] Other sales areas were designated as exclusive territories.

Chrysler Corporation restricted by agreement the number of competing dealers handling the same make of car in a given metropolitan area. Most of the General Motors agreements provided for factory surveys of the potential market in multiple-dealer cities and for the limitation of the number of dealers in such cities in proportion to the potential volume of business.[2]

In 1939 Company 116, manufacturer of men's hats, reported that in small towns it might sell only to the leading store. The decision depended upon the ability of the merchant and the position he enjoyed in the town. In the larger cities the company never granted an exclusive agency, but sold to selected retailers. In a given shopping district in a metropolitan area the company sold to only one of a given type of retail store.[3]

The difficulty of guaranteeing dealers exclusive sales rights to one section of a city probably accounts for the practice of granting nonexclusive rights in large cities. Even when dealers are scattered among the shopping districts of the metropolitan market, attempts to limit the sales of a given retailer to people living in that section of the city contiguous to the retail store are likely to be impracticable.

People living in the suburbs and working in the business district of the city may purchase in a downtown store, instead of in a suburban store. Then, too, a given store advertising a special sale in the metropolitan newspapers might draw customers from all the other dealers' territories. Finally, when outside salesmen are used these salesmen naturally solicit their neighbors, friends, relatives, and acquaintances, even though these people do not reside in the salesmen's territories.

Recognition of such difficulties was implicit in the "territory security plan" introduced by the Chevrolet Motor Company in 1938. Under this plan dealers were required to pay a $25 to $35 sales adjustment for sales made within the corporate limits of the community in which another dealer was located. The sales adjustment, however, did not apply among the several dealers operating within the corporate limits of a multiple-dealer city. All dealers in such a city had open territory within the corporate limits of the community, inasmuch as no attempt had been made to zone multiple-dealer cities.[1]

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[1] Federal Trade Commission, *Report on Motor Vehicle Industry,* Pursuant to Joint Resolution No. 87 (H. J. Res. 594), 75th Congress, 3d Sess. (Washington, D.C., U.S. Government Printing Office, 1939), p. 117.

[2] With respect to sales territories, the Federal Trade Commission summarizes the practice of the industry as follows: "The majority of the manufacturer-dealer agreements designate the dealer sales area and provide that the dealer shall have the right (exclusive or nonexclusive) to purchase motor vehicles for resale in the described sales area and not elsewhere. . . .

. . . .

Similarly, the various manufacturers, including Ford Motor Co., Nash-Kelvinator Corp., Chrysler Corp., Packard Motor Co., General Motors Corp., Studebaker Corp., Hudson Motor Car Co., Graham-Paige Motors Corp., Hupp Motor Car Corp., and Willys-Overland Motors, Inc., grant exclusive territories to their distributors and some of their dealers, and limit the number of dealers in a selling area as a matter of administrative policy, even though their agreements may not refer to the subject." (*Ibid.,* p. 117.)

[3] Evidence collected by personal interview and correspondence.

Thus, instead of dividing a large city into territories, it is more practicable to appoint dealers with nonexclusive rights. Among other methods, competition may be minimized by scattering the dealers among the shopping districts of the metropolitan market, by appointing only one store of a given type in a specific shopping district, and by limiting their number in proportion to the size of the potential market.

TERRITORY INFRINGEMENT

Even when exclusive sales rights are granted to one dealer in a city, numerous problems may arise in connection with the tasks of determining the exact nature of territorial rights and then of protecting those rights. The attitude of automobile manufacturers on the problem of territorial infringement is summarized as follows by the Federal Trade Commission:

> Many years ago several agreements contained restricted-territory provisions, as well as territory infringement penalty provisions. The practice of penalizing a dealer for infringing on another dealer's territory fell into disuse and very few agreements carried infringement penalty provisions and, in fact, many agreements failed to even describe a sales area during the early part of the decade. However, in recent years the trend has been to restrict a dealer to a described sales area and to actively enforce penalty provisions when a dealer sells a new car into another dealer's sales area.
>
> The majority of the manufacturer-dealer agreements provide for some form of adjustment (so-called penalty) in case the dealer sells a new passenger automobile into the protected territory of another dealer handling the same make of automobile. While the precise nature and form of dealer infringement compensation varies with each agreement, the majority of the agreements provide that the dealer who sells an automobile into the protected territory of another dealer of the same make of automobile will pay a sum of money to that dealer directly or through the distributor or manufacturer as compensation (so-called penalty) for the infringement.[2]

The territory security plan of the Chevrolet Motor Company illustrates a recent attempt to solve the problem of territory infringement without interfering with normal, competitive trading practice.

Under the territory security plan, any dealer could sell to any customer anywhere. Any customer could buy from any dealer anywhere. But if a dealer located in one city made a sale to a customer living within the corporate limits of a second city in which another dealer was located, the selling dealer was obliged to make a $25 voluntary adjustment or a $35 imposed adjustment. All dealers located in multiple-dealer cities had open territory within the corporate limits, but were protected against raiding from dealers located outside the corporate limits.

This plan was designed to meet the problem of constant sales raiding and cross-selling between dealers without interfering with a dealer's competitive selling liberty.[3]

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[1] G. G. Baird, "Chevrolet Inaugurates Protected Territories," *Sales Management*, Nov. 15, 1938, pp. 24–25.

[2] Federal Trade Commission, *op. cit.*, p. 118.

[3] Baird, *op. cit.*, pp. 24–25.

The foregoing information indicates how the problem of defining exclusive sales rights has been met in the automobile industry. Space does not permit further discussion on the general question under consideration.

DESIGNATION OF BRAND

An important feature of the exclusive agency agreement is the statement about the specific brand to which sole selling rights apply. Among the companies studied that granted exclusive agencies, the general practice appeared to be that of manufacturing one brand and of granting the exclusive sales rights for that brand in a specified territory to one retailer. On the other hand, some manufacturers found that the plan of granting exclusive agencies had a tendency to limit sales unduly in the larger cities. In order to provide for more satisfactory development of large city markets, some companies had added a second and even a third brand to the line.

Thus, where additional representation is necessary to secure a satisfactory proportion of the potential sales volume in a large city, one retailer may be given the exclusive sales rights for the second brand, and one retailer exclusive sales rights for the third brand. By so doing, the company retains the practice of exclusive representation for a given brand but secures wider exposure to sale for the output of the company.

As an example of this policy, the case of Company 11, a manufacturer of high-grade men's clothing, may be mentioned.[1] This company distributed its products through 1,000 retailers located throughout the United States. The company had two separate brands of its own. Exclusive agencies for the main brand had been granted to one retailer in each community. In cities of over 10,000 population the company had given an exclusive franchise for its second brand to another retailer. In some cities other retailers also sold the company's line under a private brand. Yet the company had only one representative in each community with the franchise for one brand.

The foregoing discussion serves to illustrate the point that the exclusive agency agreement does not necessarily refer to the entire output of the manufacturer but may apply to only one of two or three separate brands marketed by the company.

EXCLUSIVE HANDLING OF ONE MANUFACTURER'S LINE

The exclusive agency agreement may or may not contain a provision with respect to selling competing lines. In the case of automobiles, the dealer is usually required to confine his efforts to a single line of new cars.[2] Retailers of men's clothing, on the other hand, may sell more than one brand but usually not in the same price class.[1] The same applies to men's shoes.[2] In any event, whether specified in the franchise or not, the exclusive agent for a given brand does not generally sell a directly competing brand in the same price class.

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[1] Data secured by questionnaire.

[2] "For years it has been the general policy of each motor vehicle manufacturing company to limit its dealers to the exclusive handling of its line of cars. This, in general, is true of both large and small manufacturers." (Federal Trade Commission, *op. cit.*, p. 1071.)

The exclusive agency agreement may carry provisions with regard to maintenance of stock, quota of purchases by the retailer, purchase price, selling price, and other matters. Space does not permit the consideration of these questions.

SUMMARY

In summary, the essential features of the exclusive agency arrangement are these: (1) The manufacturer agrees to sell a specified brand through only one retail outlet in a described territory. (2) The territory may include the area within the corporate limits of a community, a retail trading area, a section of a large city, or some other geographical area. The common practice among the companies covered was to make the city the smallest territorial unit in which exclusive sales rights were granted. (3) While the exclusive agency may apply to the manufacturer's entire line, in some instances it may cover only one of two or three company brands.

JOINT AGENCY DISTRIBUTION

Joint agency distribution involves less restriction in number of outlets per territory than exclusive agency distribution. On the other hand, it aims at greater restriction in number of retail representatives per territory than is the objective of the policy of nonselection.

DEFINITION

The policy of joint agency distribution is followed when the manufacturer (or his wholesale distributor) grants two or more retailers the nonexclusive right to sell his brand in the same geographical area but limits the number so appointed by agreement or by administrative policy.[3]

The policy of joint agency distribution is well illustrated by the plan followed by the several selling divisions of General Motors Sales Corporation in 1939. According to the Federal Trade Commission, General Motors Sales Corporation usually designated metropolitan areas as nonexclusive territories.

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[1] As reported by Company 107, manufacturer of high-grade men's clothing, in the course of an interview.

[2] Company 102, manufacturer of high-grade men's shoes, indicated that its exclusive agents did not carry its line exclusively. In addition to the company's line, priced at $10 and up, the retailers usually carried a line of $8 shoes, and a line of $5 shoes. However, retailers carried only the company's brand in the price line $10 and up. (Data secured by personal interview.)

[3] In the process of defining exclusive agency selling the Committee on Definitions of the National Association of Marketing Teachers also defined the term "joint agency" as follows: "*Exclusive Agency Selling.* That form of selective selling whereby sales to any one type of buyer are made through one dealer or distributor in each geographical area usually on a contractual basis.

"*Comment.* This definition does not include the practice of designating two or more distributors in an area as exclusive agent. While this is a form of selective selling it is not *exclusive agency selling.* It is recommended that the term Joint Agency be applied to the arrangement." ("Definitions of Marketing Terms," p. 152.)

Most of the General Motors agreements provided for factory surveys of the potential market in multiple-dealer metropolitan areas and for the limitation of the number of dealers appointed in those areas in proportion to the size of the potential sales volume.[1]

NONEXCLUSIVE SALES RIGHTS GRANTED

Thus one outstanding characteristic of joint agency distribution is the practice of granting nonexclusive sales rights to two or more dealers located in the same territory. This practice is in contrast to that followed under exclusive agency distribution when one dealer is granted exclusive sales rights in a given territory.

NUMBER OF DEALERS PER TERRITORY LIMITED

Another important characteristic of joint agency distribution is the practice of limiting the number of dealers granted nonexclusive sales rights in a given territory either through agreement or by administrative policy. Thus, in 1939 Chrysler Corporation restricted by agreement the number of competing dealers handling the same make of car within the nonexclusive metropolitan areas.[2] On the other hand, Ford Motor Company restricted by administrative policy rather than by agreement the number of dealers appointed in a natural selling area.[3]

With respect to the practice of limiting the number of selling representatives granted nonexclusive rights within the same geographical area, joint agency distribution differs from the policy of nonselected distribution. Nonselected distribution is characterized by the aim of selling to any and all dealers in a given geographical area, except for minor restrictions growing out of the practice of refusing to sell to retailers who do not pay their bills.

OTHER ASPECTS

A complete discussion of joint agency distribution would involve consideration of additional points, such as: designation of the brand to which nonexclusive sales rights apply, whether the dealer is required to handle one manufacturer's line exclusively, definition of territory in which the dealer operates, nature of protection against infringement of territory, and other points. The discussion on most of these points would tend to parallel that presented in the section dealing with exclusive agency distribution. For this reason, and because further discussion would not contribute to the main issue of this study, these points will not receive additional consideration.

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[1] Federal Trade Commission, *op. cit.*, p. 117.

[2] *Ibid.*

[3] "The Ford Motor Co. sales agreement provides that Ford dealers can resell its products anywhere within the boundaries of the United States, subject to the right reserved by the company to sell direct to other dealers and to retail purchasers in any part of the United States, and subject also to the provision that the dealer, on request by the company, must turn over to Ford Motor Co. orders received from the United States Government or any of its departments or from the American Red Cross, without remuneration. Ford Motor Co. also restricts, by administrative policy rather than by agreement, the number of dealers in a natural selling area." (*Ibid.*)

EXCLUSIVE AND JOINT AGENCIES COMBINED IN COMMON TYPE OF DISTRIBUTION ORGANIZATION

Evidence collected in this investigation indicates that the practice of appointing one dealer per city regardless of size is followed in a relatively small percentage of cases. Instead, when selected distribution is followed, the common practice is to appoint one dealer in the smaller cities but to select several representatives in the larger cities.

Thus, out of 56 companies which reported that they granted an exclusive agency to one dealer per city in part or all of the cities covered, only 6 made a city the exclusive territory of one dealer regardless of the population.[1]

The following examples illustrate this policy. Burkhardt Company, manufacturer of high-quality men's suits and overcoats, followed the policy of granting an exclusive agency to one retailer in each community. Although company officials believed that the exclusive agency policy resulted in inadequate coverage in the larger cities, it was thought to be an essential feature of the Burkhardt market plan.[2]

Similarly, Company 42, a manufacturer of expensive pianos, followed the policy of exclusive agency distribution in all cities in which its pianos were sold. Exclusive sales rights were granted to only one retailer per city, the policy applying equally in New York City and Chicago as well as in smaller cities and towns.[3]

Company 27, manufacturer of high-quality ladies' full-fashioned silk hosiery, provides a final example of the same policy. The company sold through only one retail outlet in New York City and one in Chicago, as well as in the other communities where the brand was marketed.[3]

In contrast, 50 out of 56 reporting companies followed the practice of making a city the exclusive territory of one dealer in smaller communities, while appointing two or more retail representatives in larger cities. Typical examples of this policy follow.

Company 13, manufacturer of high-grade men's shoes, granted exclusive sales rights to one retailer per city, except in 10 leading metropolitan areas.[3] For example, in Chicago the company had 20 dealers; in New York City, 30.

Company 5 manufactured mechanical refrigerators. In cities of 25,000 population and less the company gave one dealer an exclusive franchise to hold and protect as long as he was able to provide a fair percentage of the total available business.[3] In cities of more than 25,000 population selected dealers were appointed. The company used a formula of one retail outlet per 25,000 population as a rough guide for dealer coverage. In Chicago the company had 160 dealers; in New York City, 300.

Company 64 manufactured medium-price automobiles which were sold through dealers, some having exclusive rights, others nonexclusive or co-extensive rights.[1] In cities of 10,000 population the company had an average of one dealer; in cities with 1,000,000 population from 5 to 10 dealers; in Chicago proper 25 dealers; and in New York City (including the Bronx, but not Brooklyn) 15 dealers.

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[1] This statement is based upon a study of the questionnaire and case evidence on distribution policies and practices which is summarized in the Appendix.

[2] From the Burkhardt Company case, on file at the Harvard Graduate School of Business Administration.

[3] Data secured by questionnaire.

RESTRICTION OF DISTRIBUTION

Now that the policy of selected distribution has been defined and discussed the next step is to present evidence indicating the extent to which distribution is restricted in the application of such a policy. Data on this point were secured, along with other material, by questionnaire, personal interview, and correspondence. Manufacturers were asked to indicate how many retail outlets were used in distributing their products, on the average, in communities with a population of 10,000, 100,000, and 1,000,000, as well as in Chicago and New York City.

From the complete tabulation of replies, companies with a relatively large number of dealers in New York City were selected, as well as companies with a relatively small number of dealers in New York City. In addition to these companies, others were chosen whose practice in restricting outlets in New York City fell between the two extremes. The distribution organizations of these companies are described in Exhibit 1. . . .

These data indicate that as the size of the city increases there is a tendency for a given company to use a larger number of retail outlets. Thus, on the average, Company 17, manufacturing automobile tires, had 5 retailers in cities of 100,000; 12 retailers in cities of 1,000,000; 25 in Chicago; and 35 in New York City. Likewise, on the average, Company 15, manufacturing men's, women's, and children's shoes, had 2 retailers in cities of 10,000; 25 retailers in cities of 100,000; 150 retailers in cities of 1,000,000; 300 in Chicago; and 700 in New York City.

Also, the number of retail outlets through which products were distributed in New York City varied from 1 to 1,500. In connection with the Reber Silk Hosiery Company, with 1,500 retail outlets in New York City, the question might well be raised to what extent this organization had actually restricted the number of dealers appointed.[2] A similar question might be raised in connection with Company 15 (shoes), with 700 outlets in New York City; Company

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[1] Data secured by questionnaire.

[2] In the Reber Silk Hosiery Company (*A*) case, written by the author, it was stated: "The company followed the policy of restricting distribution, adjusting the number of outlets in a given city to the size of the market." Inasmuch as the company sold through 1,500 outlets in New York City, further information was requested by correspondence with respect to the practice followed in this market. A company official replied that the company restricted the number of retail outlets in New York City to less than the number which would have been willing to sell the brand. The basis upon which the number of outlets was restricted is indicated in the following quotation:

"Our policy with regard to restricting our outlets in New York City depends on several factors. If a dealer is doing what we consider a good business with us, we will protect him within a certain area. By that I mean we will not sell another store within a certain number of blocks.

"The size of this protected area is decided individually in each case and varies, depending on the volume of retail business and, therefore, the potential Blue Seal business in the district."

59 (radios), with 600 outlets; and Company 5 (mechanical refrigerators), with 300 outlets.

In order to answer these questions, the data in Exhibit 2 are presented. The next to the last column in this exhibit indicates the number of retailers that commonly sold the type of product manufactured by each of 6 companies considered in the tabulation. The figures in this column are based upon information presented in the Census of Retail Distribution and can probably be accepted as only an approximation of the desired data. By dividing the number of retailers selling the company's brand by the number of retailers that might possibly have sold the brand a rough indication is obtained of the degree to which distribution has been restricted.

EXHIBIT 1

NUMBER OF RETAIL OUTLETS THROUGH WHICH PRODUCTS WERE SOLD BY 19 MANUFACTURERS USING SELECTED DISTRIBUTION: 1938

(Classified by size of city)

Company Code	Product	Average Number of Retail Outlets Used in Cities with Populations of			Chicago	New York City
		10,000	100,000	1,000,000		
27	Ladies' silk hosiery......	1	1	1	1	1
42	Pianos..................	1	1	1	1	1
14	Pianos..................	1	1	...	2	3
6	Space heaters..........	1–2	2 or more	...	6	6
58	Men's suits............	1	1–3	5	5	10
64	Cars and trucks........	1	1 or more	5–10	25	15
50	Cars and trucks........	1	1	9	15	23
31	Women's shoes..........	1	2	4 or 5	3	25
13	Men's shoes............	1	1	...	20	30
17	Tires and tubes.........	1	5	12	25	35
8	Gas ranges.............	1	3	25	35	50
22	Men's suits............	1	5	15	60	75
33	Washing machines......	...	..	...	80	120
101	Men's shoes............	*	*	*	125	200
23	Sportwear.............	3	7	25	300	250
5	Mechanical refrigerators.	1	4	40	160	300
59	Radios................	2	25	250	400	600
15	Shoes.................	2	25	150	300	700
Reber	Ladies' silk hosiery.....	1	3	...	60	1,500

* The company reported one outlet used in a medium-size city.
Source: Mail questionnaires, personal interviews, case studies.

On this basis, it appears that the 1,500 retailers through which Reber hosiery was sold in New York City constituted only 14% of the number of stores that commonly sold silk hosiery. The company's statement that the policy of selected distribution was followed in New York City, as well as in other communities, is therefore verified. Likewise, the 700 retail outlets handling the shoes of Company 15 amounted to only 6% of the number of stores that commonly sold shoes in New York City. Similarly, the 600 retail outlets selling the radios of Company 59 constituted only 10% of the number of stores that normally sold radios in New York City.

In short, those companies selling through the largest number of retail outlets in New York City in 1938 had actually restricted their distribution to between 6% and 14% of the number of retailers which commonly sold such merchandise.

EXHIBIT 2

DEGREE TO WHICH 6 COMPANIES MANUFACTURING DIFFERENT PRODUCTS RESTRICTED DISTRIBUTION IN NEW YORK CITY

Company Code	Product	Number of Retailers in New York City		Percentage of Possible Outlets Used by the Company †
		Selling the Company's Brand (1)	Commonly Selling the Product * (2)	(3)
Reber	Ladies' silk hosiery........	1,500	10,587	14.2%
15	Shoes....................	700	10,993	6.4
59	Radios..................	600	5,774	10.4
5	Mechanical refrigerators....	300	7,699	3.9
22	Men's suits...............	75	1,370	5.5
17	Tires and tubes...........	35	5,213	0.7

* Estimate based on data on "Sales by Commodities" published by the U.S. Bureau of the Census (*Fifteenth Census of the United States: 1930; Distribution*, Vol. I, *Retail Distribution*, Part III, Table 15), and data on "Kinds of Business, by Areas," published by the U.S. Bureau of the Census (*Census of Business: 1935, Retail Distribution*, Vol. III, Table 1*A*, p. 70).

† Figures in column 1 divided by figures in column 2.

These figures are in marked contrast to the percentages cited on page [297] for 19 dentifrice firms following a policy of nonselected distribution. For these firms, it will be recalled, the percentage of retail drug stores surveyed which carried the several brands varied from 51% to 98%.

ADVANTAGES AND DISADVANTAGES OF SELECTED DISTRIBUTION

After having defined and described selected distribution, it is next desirable to indicate briefly the nature of the advantages and disadvantages experienced by manufacturers making use of this type of distribution.[1]

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[1] Although the following discussion is based primarily upon the individual cases cited below, helpful material was found in the following sources: "The Use of Exclusive Retail Agencies," *Harvard Business Review*, Vol. III, No. 4, pp. 485–497. *The Exclusive Agency* (New York, New York University, 1923), *passim*. H. H. Maynard, W. C. Weidler, and T. N. Beckman, *Principles of Marketing* (rev. ed., New York, Ronald, 1932), p. 688.

ADVANTAGES

First, this policy secures more aggressive retail selling and advertising than can normally be expected under the policy of nonselected distribution.[1] By restricting the number of retailers appointed in a given community, competition between outlets is minimized, if not eliminated. To a varying degree, depending upon the extent to which distribution is restricted, the individual retailer is in a position to reap the benefit of his own aggressive selling effort without benefiting his competitors. In consequence he is willing to put forth more aggressive sales efforts than otherwise would be the case.[2]

Secondly, for products such as shoes and paint, retailers are required to make a large investment in order to provide an adequate stock of the manufacturer's product. Because of the large investment required, a given retailer cannot be expected to carry a complete stock of many brands. Moreover, if this retailer's competitors are selling a given brand, the available sales volume may be too small to justify the investment necessary to provide an adequate stock of the same brand. Thus the retailer may carry incomplete stocks, with the result that sales will suffer. On the other hand, even though a large investment is required, the retailer will carry an adequate stock of the brand provided distribution is restricted sufficiently to give an adequate return on his investment.[3]

Thirdly, there are other products, usually mechanical in nature, that require service on various occasions throughout their period of usage if they are to operate satisfactorily. Automobiles provide a good example of such a product. To maintain a properly equipped service department with an adequately trained personnel, however, involves the dealer in considerable expense. If the manufacturer sells his product to as many dealers in a given community as will stock the product, and still expects them to provide the necessary service facilities, the result is almost certain to be an inferior grade of service or no service at all. By restricting distribution, the manufacturer may make it worth while for the dealer to provide the desired quality of service.

Fourthly, unit selling costs often tend to be lower under selected distribution than under nonselected distribution.[4] When sales are restricted to retailers buying in large quantities, salesmen make fewer calls and take larger orders than when the policy of nonselected distribution is followed. Moreover, sales expenses are reduced by establishing continuous relations with a smaller number of retailers than would be called upon under a policy of nonselected distribution.[1]

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[1] Copeland, *op. cit.*, p. 118.

[2] The Chocolink Beverage Company secured aggressive sales support for its product by granting exclusive agencies to retail milk companies. (*Harvard Business Reports*, Vol. 3, pp. 83–90.)

[3] See the case of the Imperial Paint Company, in Learned, *Problems in Marketing*, pp. 211–212. The size of the investment necessary for an adequate stock was one of the factors which led Frazier Company (electric ranges) to adopt a policy of selected distribution. (Frazier Company, case on file at the Harvard Graduate School of Business Administration, p. 7.)

[4] A tire manufacturer who had adopted selected distribution found that sales expenses were reduced under the plan. (Guy C. Smith, "Selective Selling as a Means of Reducing Marketing Costs," American Management Association, Marketing Executives' Series, No. 55, pp. 5–6.)

In the case of Land O'Lakes Creameries, Inc., the policy of restricting sales of butter to the better class of stores was adopted. Apparently the basic factor in selecting retail outlets was their volume of sales. Inasmuch as this organization sold a relatively narrow line direct to retailers, the cost of selling would have been very high under dense distribution. By restricting sales to retailers buying in large quantities, however, it was possible to keep the cost of selling down to a relatively low figure. (Learned, *op. cit.*, p. 169.)

Fifthly, for certain products the policy of selected distribution tends to develop a more enthusiastic and successful dealer organization than would result from a policy of nonselected distribution. The characteristics of expensiveness, high unit price, or infrequent purchase tend to limit the potential sales volume for products such as high-grade silk hosiery and pianos to a relatively small amount per 1,000 population. When this is true, the policy of nonselected distribution tends to make the line unprofitable for the retailer; in contrast, the policy of selected distribution tends to make the line profitable.[2] Also, for products such as high-grade men's suits and high-grade men's hats, retailers tend to prefer exclusive agencies if they are to handle a given manufacturer's line.[3] Under such circumstances, the policy of selected distribution has made it possible for manufacturers to build up a strong dealer organization when the policy of nonselected distribution would not have succeeded in attaining the same result.

Sixthly, in instances when the policy of nonselected distribution is followed, competition between a number of retailers in the same community tends to result in price cutting. Price cutting tends to make the brand an unprofitable item for the retailers who handle it, with the result that desirable types of retailers refuse to stock the line. Also, some manufacturers believe that price cutting damages the reputation of their brand. On the other hand, the policy of exclusive agency distribution eliminates competition between retailers in the same community and tends to prevent price cutting.[4]

DISADVANTAGES

First, some manufacturers following this policy may be forced to limit the number of dealers appointed per community to a number so small that large city markets are not satisfactorily developed. In this respect, selected distribution has been found to be a serious handicap by manufacturers of men's clothing.[1]

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[1] In the case of the Delcourt Shoe Company, exclusive agencies tended to cut down sales cost by making it possible for the company to establish continuous relations with the same group of dealers. (*Harvard Business Review*, Vol. III, No. 4, p. 490.)

[2] Reber Silk Hosiery Company, manufacturing high-grade ladies' hosiery, followed the policy of selected distribution in part because of the desire to make the Reber line profitable to the retail store. According to a company official, "We feel that any policy which would not result in a profitable operation for the store would most certainly react against us in the long run." (Quoted from a letter written to the author by an official of Reber Silk Hosiery Company.)

[3] In the case of Nugent Hat Company the primary reason advanced by the company for using exclusive agency distribution was the preference of retailers for exclusive rights to the Nugent brand in their communities. (Nugent Hat Company, case on file at the Harvard Graduate School of Business Administration, p. 3.)

[4] In the case of Carpenter Company it is reported that it was not uncommon for several retailers in a single shopping area to carry the same brand of sheets. In several instances this fact had caused price cutting among retailers; a few mills therefore had adopted an exclusive agency plan of distribution in order to overcome price cutting. (Learned, *op. cit.*, p. 172.)

In the second place, manufacturers following the policy of selected distribution face an advertising problem that is not encountered when nonselected distribution is used successfully. Because the number of outlets appointed per community is limited under the policy of selected distribution, it is necessary for the manufacturer to make certain that the local source of supply is identified through signs, window displays, and advertising over the retailer's name. Unless this identification is made, the demand created by the manufacturer's general advertising may be dissipated because of the consumers' lack of knowledge of where to go in order to buy the product.[2] This problem is peculiar to products with restricted distribution, whether this type of distribution is chosen or imposed by circumstances. Failure to recognize the importance of this problem may result in ineffective advertising.

Thirdly, selected distribution may tend to promote substitution. Dealers who cannot get the agency for a given brand may double their efforts to take business away from that brand by offering substitutes. The seriousness of this problem will depend upon the strength of the brand preference which the manufacturer can create.

Wisdom of Policy of Selected Distribution for Products Studied

Analysis suggests that the promotional problems for products wisely marketed under the policy of selected distribution may vary considerably from the promotional problems for products unwisely marketed under this policy. Consequently, before proceeding to an analysis and interpretation of the data collected in this investigation, it is desirable to make a brief appraisal of the wisdom of selected distribution for the products to be studied. Exhaustive consideration of every product upon which data were collected is not the object; instead, the purpose is simply to cover those products upon which enough data were secured to justify separate study.

Passenger Automobiles

Data were collected on the distribution policies of 8 manufacturers of passenger automobiles. Of this number, 6 reported that they followed the policy of selected distribution; 2 did not indicate what policy was followed.

Several considerations testify to the wisdom of the policy of selected distribution in the marketing of passenger automobiles. In the first place, because the high unit price of an automobile creates sales resistance, and since its long life leads owners to postpone replacement of an old car, aggressive retail selling and sales promotion are essential to a successful sales program. The policy of selected distribution stimulates more aggressive support than does the policy of nonselected distribution.

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[1] Officials of Chadborn Company, manufacturer of men's clothing, believed that the existing policy of exclusive agency distribution resulted in inadequate representation in the larger cities. (Chadborn Company, case on file at the Harvard School of Business Administration, p. 2.)

[2] This point is made in Lockley, *Vertical Co-operative Advertising*, pp. 139–140. See also Excello Tire Company, Neil H. Borden, *Problems in Advertising* (3d ed., New York, McGraw-Hill, 1937), pp. 331–337.

Secondly, the purchase is so important to the consumer that he may be expected in many instances to seek out selected dealers.

In the third place, expensive service facilities must be provided by the dealers in order to repair and maintain the cars sold. Under such circumstances, the policy of selected distribution is necessary in order to encourage the dealers to provide the desired quality of service.

Fourthly, the high unit price of the automobile, plus the already extensive ownership of cars, tends to restrict the potential annual sales per 1,000 population to a relatively small amount. If dealerships are to be made profitable, then the manufacturer must restrict distribution to the extent necessary to provide a satisfactory volume of business for each dealer over the long run.

Household Appliances of High Unit Price

Information was secured covering the distribution policies of 6 manufacturers of mechanical refrigerators, 7 manufacturers of domestic ranges, and 3 manufacturers of electric washers. Except for one manufacturer of domestic ranges who combined selected and nonselected distribution, all the foregoing companies followed the policy of selected distribution in the marketing of their products.

Here again the policy of selected distribution appears to have been a wise choice. The high unit price and long life of household appliances of this type makes aggressive retail support essential for the product; the desired degree of support is more likely to be forthcoming under selected distribution than under nonselected distribution.

Likewise, selected distribution is desirable in order to get retailers to invest in the assortment of models needed in order to demonstrate and to sell the product effectively. Consumers are likely to shop around. Selected distribution is also essential in order to get dealers to provide service facilities of the desired quality. Service is frequently necessary for mechanical products of this type.

Finally, the relatively limited annual market for household appliances of high unit price makes restricted distribution essential if a successful and enthusiastic dealer organization is to be developed.

Medium-Price and High-Price Men's Clothing

Eight manufacturers of medium-price and high-price men's clothing (suits, topcoats, and overcoats) who reported followed the policy of selected distribution. Seven of this number used the exclusive agency plan; one used the joint agency method.

A serious disadvantage of exclusive agency distribution, common among the manufacturers studied, is the fact that such distribution provides inadequate coverage of large metropolitan markets. In spite of this difficulty, however, there are a number of factors that justify the established policy of selected distribution.

First, retailers handling high-grade men's clothing prefer to sell a line that is not stocked by any other store in the community.[1] The presence of this attitude is a strong argument in favor of the policy of exclusive agency distribution for high-grade men's clothing.

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[1] The presence of this attitude was reported by an official of the Burkhardt Company.

Furthermore, exclusive agency distribution tends to eliminate the threat of price cutting. This is an important consideration in the sale of high-grade men's clothing. Again, the policy of selected distribution is essential in order to get retailers to make the sizable investment in men's clothing required to present an adequate stock of different styles, sizes, and colors to consumers. Finally, aggressive retail selling and advertising is highly desirable in the marketing of men's clothing. The desired support is more likely to be secured under a policy of selected distribution than under a policy of nonselected distribution.

SHOES

Data were secured on the distribution policies of 7 manufacturers of women's shoes, 6 manufacturers of men's shoes, and 4 manufacturers of combination lines of men's, women's, and children's shoes. These 17 manufacturers all reported that they followed the policy of selected distribution.

There are two important considerations indicating that the policy of selected distribution is to be preferred to any policy in the marketing of shoes. In the first place, a large retailer investment is necessary in order to provide an adequate range of styles, sizes, and widths in a given brand of shoes. Shoe retailers will not make the necessary investment unless distribution is restricted. In the second place, aggressive retail support for the manufacturer's brand is highly desirable in the sale of shoes. The policy of selected distribution is more likely to get that support than any other policy.

LADIES' HIGH-GRADE SILK HOSIERY

Eight manufacturers of ladies' high-grade silk hosiery reported. Of this number, seven followed the policy of selected distribution; one followed the policy of nonselected distribution.

Analysis indicates that the policy of selected distribution is a wise choice in the marketing of ladies' high-grade silk hosiery. This decision is based upon two considerations. First, it was estimated by an official of the Reber Silk Hosiery Company that high-grade silk hosiery, retailing from 79 cents to $1.65 per pair, accounted for only 20% of the total volume of hosiery business in 1938. In other words, the potential volume of business in high-grade silk hosiery is relatively limited per 1,000 population. Because of this fact, it is necessary for the manufacturer to restrict distribution in order to make his brand profitable for the retailer to carry.

Secondly, active retail display, promotion, and selling is desirable in the marketing of high-grade silk hosiery. The desired degree of support is encouraged by the policy of selected distribution.

CONCLUSIONS

In the preceding pages, brief analyses have been made dealing with the wisdom of the policy of selected distribution for passenger automobiles, mechanical refrigerators, domestic ranges, electric washers, medium-price and high-price men's clothing, shoes, and ladies' high-grade silk hosiery. Review of these analyses indicates that the policy of selected retail distribution was found to have been a wise choice in the marketing of each of these products.

Appendix

[Some interesting data showing the relationship between the number of different types of retail outlets and population are shown in the following table:]

1947 Estimates of Number of Distribution Establishments [*]

Kind of Business	Number of Stores	% Increase since 1943	Average Population per Store	Average Annual Business per Store
Retail:				
Grocery	370,000	20%	380	$ 50,000
Eating and drinking	335,000	29	420	36,000
Filling stations	240,000	31	590	16,000
Miscellaneous	230,000	34	610	42,000
Food, non-grocery	125,000	24	1,130	36,000
Apparel	90,000	13	1,570	84,000
Drugs	60,000	16	2,100	59,000
Motor vehicles	57,000	81	2,500	95,000
Hardware and farm implements	52,000	43	2,700	45,000
Dept. and gen. merchandise	50,000	5	2,800	260,000
Building materials	48,000	49	2,900	79,000
Home furnishings	47,000	58	3,000	70,000
Meat and seafood	35,000	14	4,000	48,000
Country general stores	31,000	−2	4,500	55,000
Automotive parts	28,000	69	5,000	53,000
Liquor	25,000	48	5,600	76,000
Radio and appliances	25,000	99	5,600	56,000
Shoe	20,000	3	7,000	75,000
Total—retail	1,868,000	29%	75	$ 51,000
Service:				
Barber and beauty	225,000	23	630	$ 3,400
Business services	135,000	56	1,050	10,600
Laundry and cleaning	104,000	11	1,350	12,000
Miscellaneous personal	101,000	37	1,400	7,800
Auto repair	89,000	48	1,580	8,500
Amusements	30,000	20	4,700	28,400
Hotels and lodgings	21,000	−11	6,700	60,000
Movie theaters	13,500	10	10,400	116,000
Total—service	718,500	29%	200	$ 12,000
Total—wholesale	230,000	50%	610	$575,000
Combined distribution	2,816,500	30%	50	

[*] These estimates have been computed from various government and private sources, including the following: Social Security Board reports on births and deaths of business firms; sales tax reports from approximately 18 states; Census Bureau benchmarks from 1939 Census, and current reports on retail, wholesale, and service establishments based on small reporting samples; Dun & Bradstreet summary of failures; other miscellaneous data compiled by the U.S. Department of Commerce.

None of the figures computed in the analysis have been published by these sources, but only the basic data.

Source: Chamber of Commerce of the United States, *Distribution News Letter*, No. 4, Mar. 7, 1947. Reprinted by permission.

LOGICS AND EMOTIONS IN MARKETING

BY STANLEY F. TEELE

That the most carefully reasoned and highly logical program can come to grief because of the failure properly to take into account the non-logical, emotional reactions of the people affected is the lesson of many an episode in political and economic history. Seemingly it is a lesson which is frequently offered but seldom learned, for statesmen and businessmen alike continue to ignore it. Strictures on this account, of course, must not be too harsh, because the ability to foresee the probable emotional reactions of people singly and, more particularly, in the mass is a rare gift; and the development of an understanding of the basic principles required for such foresight, if any exist, must wait on vastly more study than has yet been accorded the problem.

The purpose of this paper is to survey one battleground on which just such a conflict between logic and emotion is occurring. The contest is one in which the victory has not yet been decided, in which there is genuine uncertainty whether developments conforming to a basically logical pattern will be hamstrung by the emotional reactions which they have aroused. The battleground is the field of marketing; more particularly, marketing by large-scale institutions.

The changes in production which have taken place during the last century need no rehearsal here. Essentially these changes reflect revolutions in the logics of technology and management. The application of the logics of steam, of electricity, and of chemistry has gone hand in hand with the application of the logics of management, of organization. The development, on the technical side, of a cheap and convenient motive power for the carrier belt has been accompanied by the development, on the management side, of the specialized individual in the assembly line.

In hundreds of large manufacturing plants the applications of the technological and management logics have resulted in a harmonious unit beautiful in the speed and precision with which it operates. But increasingly voices are being heard, even where there is the keenest appreciation of what the logics have accomplished, emphasizing the present and potential danger of the failure of an understanding of the importance of sentiments and emotions to keep pace with the understanding of the principles of technologies and of organization. These dangers are no less great and are even more immediate in the field of marketing.

The far-reaching changes which have taken place in marketing during the last few decades similarly may be viewed as the results of efforts to apply logics to marketing methods. When they are so viewed, however, at least three distinct contrasts appear between production and marketing. In the first

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Source: Malcolm P. McNair and Howard T. Lewis, eds., *Business and Modern Society* (Cambridge, Harvard University Press, 1938), pp. 295–312. Reproduced by permission.

place, technology has been markedly less significant in bringing about changes in marketing methods than in production methods. Indeed, changes in marketing methods have come about as a result of the revolution in management methods almost to the exclusion of the revolutions in technology. There are many exceptions to this statement. New transportation facilities, made possible by technological advances and newly created advertising media, have mightily affected marketing methods. The handling of merchandise in warehouses in a manner suggestive of the assembly line in automobile production, the use of bookkeeping and tabulating machines for the preparation of marketing records, the development by large retail stores of automatic equipment for authorizing credit transactions and for making change, the employment of the telephone in retail sales transactions—all these and many others represent contributions of technological progress in bringing about changes in marketing. Yet, when one's mind runs over the gamut of the tasks which, taken together, are designated as marketing, one cannot but conclude that the supplementing of human efforts by mechanical devices has been of relatively small importance. The observation that goods are produced by horse power and distributed by man power is still basically valid.

A second contrast may be pointed out. The end result of technological and management revolutions in production has been a notable increase in the productivity of the individual worker. Output per worker employed in manufacturing and mechanical pursuits has exhibited a relatively steady and pronounced upward trend. To be sure, there have been temporary recessions, and the upward movement has not been on a straight line; but the long-time advance has been a major, if not the primary, characteristic of our industrial history. Because so much of the work in distributive enterprises is intangible, with no such simple basis of measurement as the amount of physical output, and because adequate statistics on the distributive trades are of recent origin, it is peculiarly difficult to develop an accurate record of the trend in output per worker. But what evidence there is points strongly toward the conclusion that, if there has been an increase in the productivity per worker in marketing, it has not been commensurate with the increase in output per worker in production. In other words, the enlargement of marketing activities over the years has been accompanied by a substantial, if not proportionate, increase in the number of workers required to perform the distributive functions.

Moreover, and this is the third contrast, the efforts to apply management logics in the development of marketing methods began much later than did similar efforts in production. Indeed, it is probably a fair statement that these efforts really did not reach substantial proportions until the development of large-scale enterprises, until the growth of department stores, mail-order houses, and chains. Although many of the organizations which immediately come to mind in these categories had their origins in the 1870's and 1880's, and a few even earlier, it is essentially true that the great period of growth of these organizations has been the last three decades. Some, at least, of the very evident uncertainty as to the proper logics to be applied in marketing, in contrast to the relative certainty in production, unquestionably must be ascribed to the shortness of the period during which such applications have been attempted.

The efforts of business management to apply logics to marketing activities during the last thirty or forty years have followed at least five well-defined paths, many of them leading in different directions. Moreover, there has been a wide divergence among different concerns as to the particular details of the attempt to apply the basic logics.

The specialization of the individual worker on a particular function with the objective of a consequent increase in the skill with which that particular function is performed may be considered the most important of the attempts to apply logics to marketing. It is the essential core of large-scale marketing. Reference to some of the important types of large-scale marketing enterprises will illustrate this point. First, there is the urban department store. Although some of our department stores go back seventy or eighty years, the period of the rapid development of such concerns covers only the last three or four decades. In 1935 some 4,000 department stores made about 9.5 per cent of the total sales at retail in the United States. The essence of the organization of the department store has been the specialization of individual employees by function. The employee within a department has been restricted to selling, and in some instances to taking care of the stock. Receiving and marking, delivery, granting of credit, accounting, advertising have all been specialized in the hands of individuals devoting all their time and efforts to the particular function. But the department store typically has not gone the whole way in the specialization by function, because the buyer or department manager is still responsible for the supervision of both the buying and the selling functions. In recent years, however, the question increasingly has been posed whether the logic of specialization by function does not call for a separation of the responsibility for buying and selling.

Another example of the effort to apply the logic of the specialization of the individual worker on particular functions is the chain. The rapid development of the chain store came in the period between 1910 and 1930, with particular emphasis on the latter half of the period. In 1935, chain store enterprises operated 127,000 stores out of a total in the United States of 1,650,000, and secured 22.8 per cent of the total retail sales. This last figure represents a decline from the proportion of the total business secured by chains in 1933, but it is still above the proportion in 1929. Between 1929 and 1933 the proportion of the total retail business achieved by the chains advanced from 20 per cent to 25.4 per cent. These figures, however, do not provide a true measure of the increase in importance of the chain type of organization. There has been a marked difference in the extent of the development of chains among different types of stores. Multiple-unit enterprises have been most important in the food field, in the variety field, and in the operation of filling stations. They have been less important among furniture stores, automobile dealers, and stores selling other durable consumer merchandise. Since the decline in total sales of furniture, automobiles, and so on was distinctly greater between 1929 and 1933 than the decline in items of regular constant consumption, it followed, from a simple mathematical standpoint, that the percentage of sales made by chains rose. The decline in the percentage of business done by chains between 1933 and 1935 does not, however, appear to be explained by the converse, that is, a more rapid rate of increase in the sales of the durable items between those two years; for the percentage of the total business done by chain stores fell, not only in the aggregate, but also specifically in the food field and among filling stations. Indeed, the decline in the business of chain filling stations was exceedingly striking, from 35.5 per cent of total sales in 1933 to 21.5 per cent in 1935. Similarly the proportion of the total business done by chain food stores fell from 44 per cent to 39 per cent. These changes probably do not represent any slackening in the force of the logic of specialization by function as carried out in the typical chain enterprise; on the contrary, the continued increase in the relative importance of chains in certain other fields clearly reflects the growing necessity in those fields for such specialization by function. For example, the record shows a continued advance in the importance of chains among women's ready-to-wear stores, among department stores, and among shoe stores. In all these institutions the acceleration of fashion change has demanded new and greater skills. In the effort to develop these skills there has been steadily increased application of the logic of specialization by function. The explanation for the decline in the relative importance of chains in those areas where they had been most firmly established must be sought primarily in factors external to the organizations themselves, in the social and political consequences, rather than in the economic consequences of their policies.

Specialization of individuals by function has not been limited, of course, to the retail field. The essential characteristics of specialization of individuals by function in the large-scale wholesale enterprises may be observed with no less clearness than in the retail field.

Nor has the application of this particular logic been limited to large-scale corporate enterprises. During the last decade there has been a notable development in the cooperative efforts of small retailers. In the grocery field, for example, it is estimated that approximately 110,000 independent retailers have become members of some 800 voluntary chains or retailer-owned cooperatives. The original objective of most of these organizations was to secure buying power more nearly comparable with that of their corporate competitors. But the majority of the organizations which have endured have progressed to the point where they are very definitely seeking to secure for their members the skill which is made possible by specialization of function. To an extent which differs markedly from organization to organization, but which is impressive in the aggregate, the voluntary chains are providing for their members specialized merchandising and buying ability, specialized sales promotion ability, and constant advice and assistance on the details of store operation, from accounting to layout. It is not suggested that the voluntary chain in the grocery field represents the ultimate pattern in the application of this particular logic, but it is significant to observe that in the best of the voluntary chains the advantages secured by the corporate chains through the specialization of a particular individual on a particular function are combined with the incentive which may come from individual proprietorship.

In the marketing organizations of manufacturers also one can find innumerable examples of the application of the logic of specialization of individuals by function. Not only is the salesman commonly restricted to the single function of selling, but in many companies the salesman is specialized as to the type of consumer upon whom he calls. Or, again, the salesman is specialized as to a particular part of the line manufactured by the company.

Thus one may conclude that the application of the logic of specialization of individuals by function has been fruitful in bringing about changes in marketing methods and institutions.

The second main path which has been followed in the application of logic to marketing has been the specialization of institutions by function performed, by commodities, and by quality level or price. Illustrative of the specialization of institutions by function are the advertising agency, the credit agency, and the collection agency. All these represent a segregation of functions which might be performed by a non-specialized marketing organization, with the objective of securing greater skill in their performance by the concentration of the attention of all the individuals in the organization on the single function. Examples of specialization by commodity are the men's shoe store and the hosiery store. Here again the objective is so to limit the variety of problems which must be dealt with by management that an increase in skill results. Another type of specialization by institutions is that of quality or price level. In a measure, of course, most retail organizations limit the portion of the quality scale which they endeavor to cover. More significant are the limits set up by the fixed-price variety chain or by the one-price clothing or shoe store. In these institutions, as in those specialized by commodity, there has been the effort to improve efficiency by limiting the variety of management problems.

The third major path along which business management has sought to apply logics to marketing has been the transfer and recombination of functions among different types of marketing institutions. One of the pronounced characteristics of present-day marketing is the degree to which familiar designations such as wholesaler, retailer, broker, manufacturer's sales branch, fail to describe institutions which as a class perform similar functions. Widespread acceptance has been given, in this country, to an altogether fallacious belief that there once existed a simple and sound pattern of distribution from which we have deviated with unfortunate results. According to this notion, the "natural" or "normal" marketing pattern involved the movement of goods from manufacturer to wholesaler to retailer, with certain groups of functions definitely assigned to each of these links in the chain. The manufacturer decided the product or products to be made, assumed the responsibility for designing both product and package, manufactured the goods, owned the trade-mark, advertised the goods through various media to dealers and to the public, and employed a sales force to sell the merchandise to wholesalers. Wholesalers purchased products from a number of manufacturers in large quantities, broke bulk, carried stocks for the purpose of filling orders promptly, employed salesmen to call on retailers, made deliveries, and commonly extended credit. Retailers, in turn, bought from wholesalers in smaller quantities, made stocks of a variety of goods available in convenient locations for selection by the public, arranged them in displays, sometimes advertised, and provided salespeople to serve their customers.

This simple pattern was never characteristic of all marketing. Many years ago the grocery, drug, and hardware trades were known as the "jobbing trades" and thereby distinguished from other trades in which the use of wholesalers was less universal. Thus it is apparent that alert businessmen even then realized that there were no rigid rules as to what functions should be performed by particular types of organizations. And certainly during the last thirty years this pattern has been altogether inadequate.

Dissatisfied with the results obtained by selling through wholesalers, some manufacturers undertook to sell direct to retailers, enlarging their sales forces and frequently establishing branch warehouses to facilitate the prompt delivery of orders. Naturally this assumption of additional functions was accompanied by the assumption of additional costs. Other manufacturers assumed some, rather than all, of the functions once performed by wholesalers. For example, in some industries there has been a sharp increase in the number of orders shipped direct to retailers for the account of wholesalers. Again, other manufacturers have found it desirable to establish their own sales organizations to make the initial sales to retailers and turn the orders over to wholesalers.

A contrary movement developed when wholesalers undertook to establish their own private brands. This undertaking necessarily carried with it the assumption by the wholesaler of the responsibility for the maintenance of quality, for the design of the product, and for advertising and sales promotion generally. This transfer of functions from manufacturer to wholesaler was also accompanied by a transfer of costs.

Perhaps the most significant example of the transfer and recombination of functions has been the reaching out of large-scale retailers to perform a larger share of the marketing tasks. The contrast between the small neighborhood store and the large urban department store is striking. Whether he deals with wholesalers or buys direct from manufacturers, the proprietor of the small store is typically the passive element in the transaction. The vendors come to him; merchandise is offered to him, complete in every detail; window displays, worked out by manufacturers' advertising departments, are made available to him. In contrast, the large department store typically takes the initiative in the transaction; it sends its buyers to important markets; not infrequently it will induce manufacturers to make up merchandise according to its designs; it often works out and makes available to manufacturers effective methods of promoting the sale of products. In the first situation manufacturers have large selling expenses and retailers small buying expenses; in the second, manufacturers have reduced selling expenses and retailers large buying expenses.

Chains, particularly in the grocery field, have gone even farther in the integration of marketing functions. All food chains of noteworthy size are combination retailer-wholesalers; many are, for a substantial part of their merchandise, combination retailer-wholesaler-manufacturers, reaching back to the agricultural producer in this country or in foreign countries and performing all functions up to the final sale to the ultimate consumer.

Such a concern as Sears, Roebuck and Company, buying raw materials in large quantities, drawing up specifications for merchandise, letting out the manufacturing on a contract basis, using its own brand name, promoting its merchandise through advertising and display, and selling to millions of customers through its catalogues and hundreds of retail stores, has moved far beyond the functions labelled "retail" in the oversimplified "normal" scheme.

From this development two clear-cut and antagonistic patterns are emerging in the marketing of consumers' goods. A definite struggle between what may be called "manufacturer-dominated marketing" and "retailer-dominated marketing" is in process. When Sears, Roebuck and Company or Montgomery Ward & Company or J. C. Penney Company, Inc., or R. H. Macy & Co., Inc., or the Great Atlantic & Pacific Tea Company determines what is to be manufactured and how the product is to be designed and packaged, applies its own brand names, does its own sales promotion and selling, and leaves to the manufacturer only supervision of the actual manufacturing process, the retailer clearly dominates. Conversely, when the manufacturer retains control of all functions except those involved in the final transaction with the ultimate consumer, it is he who clearly dominates. The conflict between these two, of course, is not new; but it has become increasingly difficult for manufacturers to emphasize their own branded products and at the same time to supply large-scale retailers with merchandise to be sold under private brands.

The assumption of wholesale functions by manufacturers, the development of private brands by wholesalers, the reaching out by large-scale retailers by no means exhaust the list of examples of the transfer and recombination of functions during the last few decades. Experiments in this direction have not always had happy results. Many manufacturers have found that the lure of more aggressive selling which led to the establishment of their own wholesale branches and to the organization of sales forces for direct solicitation of retailers hid the unbearably high operating costs. On the other hand, the integration of marketing functions by large-scale retailers has provided the opportunity for some highly important economies in distribution. The solicitation of the business of small retail outlets by the salesmen for a number of competing wholesalers and manufacturers necessarily involves duplication of effort; deliveries from each vendor to each store are necessarily small and therefore relatively costly; contacts are intermittent and cannot be completely regularized; throughout, there is lost motion and waste of human time and effort. In contrast, in the chain the individual store draws nearly all its merchandise from a single source; the delivery of merchandise can be carefully scheduled with substantial shipments in the aggregate to each store; the functions of ordering, of supervising the arrangement and display of merchandise, of checking inventories, can be reduced to routine in which specialized individuals regularly perform their appointed tasks. The economies resulting from the integration of these wholesale and retail functions probably are more important in explaining the low prices offered by the chains than the elimination of such services as credit and delivery and the advantages of substantial buying power.

The fourth path along which management has sought to apply logics to marketing has been the transfer of commodities among different types of institutions. There has been extensive and continued experimentation to determine whether or not particular commodities could be sold effectively through channels once not considered suitable for them. In part, this experimentation has been made necessary by the development of new items. Consider, for example, the distribution of the many mechanical household devices developed during the last ten or fifteen years. The retail outlets through which one large manufacturer sells electrical refrigerators include radio stores, hardware stores, music stores, department stores, public utility offices, and specialized refrigerator dealers. Currently there is constant experimentation to determine the proper types of retail outlets for oil burners and for air-conditioning equipment. Anyone who studies the plans of manufacturers for marketing these and similar items cannot but be impressed by the confusion which temporarily results while the effort to develop suitable outlets is in progress.

But the experimentation with different types of outlets for particular commodities has not been restricted to items newly developed. Think for a moment of the urban drug store. Think of the range of merchandise carried by such a store today, which even fifteen years ago would have been completely foreign to the store. Consider the increasing variety of merchandise offered by many filling stations.

Experiments in the recombination of merchandise also have not always had happy results. Many of them have been poorly conceived, have been little more than unreasoned efforts to increase sales volume without adequate consideration of the basic capacity of the particular institution to perform satisfactorily in the new field. But other experiments have developed into highly important new channels of distribution for particular commodities, contributing to the well-being of the public and to the profits of the successful enterprises.

The fifth and last path has been the application of statistical and psychological methods to marketing. This is the newest path and the one on which there has been least progress, but perhaps the greatest increase in interest. Unquestionably it holds considerable promise as a means of applying logics to marketing. In contrast to the first four paths it appears to have no consequences outside the economic area, in the social and political areas.

These, then, are what seem to one observer to be the five most important paths along which management has sought to go in the application of logics to marketing: (1) specialization of the individual by function; (2) specialization of institutions themselves; (3) transfer and recombination of functions among institutions; (4) transfer of commodities among institutions; and (5) application of statistical and psychological methods. How are we to appraise the overall result? Do we have any yardstick which will measure the success of these efforts not in terms of the profits of the individual enterprise but in terms of the continuity and extent of the advance in the output per worker? Put another way, the question is: Has the application of logics in marketing permitted efficiency to rise at a rate comparable to that of the increase in manufacturing efficiency? Final and conclusive answers to these questions based on statistical evidence cannot be given. An approach to the answers may be found by examining, first, the relative over-all costs of operating our marketing and manufacturing mechanisms at the present time; and, second, by examining the trends in occupation of the gainfully employed. The census of wholesale and retail trade makes possible an estimate of the relative cost from a national standpoint of marketing activities as compared with manufacturing activities.

For many years the Census of Manufactures has given, in addition to a figure for the total value of the annual output of manufacturing plants, a figure for the value added by manufacture. This sum, which was $19,500,000,000 in 1935, represents the difference between the value of the raw materials and the value of the finished products. This figure includes manufacturers' marketing costs estimated at $4,100,000,000. Hence the value added by manufacture alone may be estimated at $15,400,000,000. A comparable figure for the value added by marketing may be secured by combining retail and wholesale gross margins with the marketing costs of manufacturers. This process involves supplementing the basic figures of the Bureau of the Census with rough estimates and requires a recognition that both the basic data and the estimates may involve as much as a 10 per cent error. In 1935 the estimated retail gross margin was $9,400,000,000, and the estimated wholesale gross margin was $4,700,000,000, and estimated manufacturers' marketing costs (not including the cost of operating wholesale branches accounted for in the wholesale gross margin) were $4,100,000,000. Thus, the estimated total value added by marketing in 1935 was $18,200,000,000. In other words, for every $1.00 of value added by manufacture, slightly more than $1.18 of value was added by marketing. As has been indicated, no close accuracy is to be ascribed to these estimates, but a very substantial error would not vitiate the conclusion that marketing bulks at least as large as manufacturing among our national economic activities. That the over-all costs of marketing are not materially different in amount from the over-all costs of operating our manufacturing plants is a measure of the importance of marketing activities today. It provides the basis for the statement so often made that the gains secured through technical progress in manufacturing are eaten up, or at least reduced substantially, by the costs of marketing. Unfortunately, figures on the value added by marketing are not available for the years prior to 1929. It is therefore not possible to use them to determine whether marketing costs have been absorbing an increasing proportion of the aggregate price paid by consumers for goods and services. Nearly every series of data which we have, however, relating to the operating costs of marketing institutions over a period of years indicates that the proportion has been increasing. Moreover, some light on the question may be secured by an examination of the trends in occupations of the gainfully employed.

One hundred years ago in this country 70 per cent of the gainfully employed had agriculture as their major occupation, although such part-time activities as lumbering undoubtedly contributed substantially to their total income. Throughout the intervening hundred years there has been a steady decline in the proportion of the population engaged in agriculture, with a low point in 1929 of 23 per cent. The two figures to be contrasted are 70 per cent a hundred years ago and 23 per cent in 1929. The decline in agriculture has been absorbed primarily in manufacturing and in trade and transportation. One hundred years ago manufacturing was the occupation of 13 per cent of the gainfully employed. In 1929, 28 per cent of the population were engaged in manufacturing. In other words, relatively two and one-half times as many people were employed in manufacturing in 1929 as in 1830. But the really startling change occurred in trade (including finance) and transportation. In 1830, 3 per cent of the gainfully employed were occupied in trade and transportation; in 1929, 30 per cent were so occupied, a tenfold relative increase as compared with the relative increase of two and one-half times in manufacturing.

It is of real significance that at present the over-all costs of marketing nearly match the over-all costs of manufacturing, while for the first time the proportion of the gainfully employed engaged in trade and transportation virtually matches the proportion engaged in manufacturing. It is a reasonable conclusion that the relatively more rapid advance in the numbers employed in trade and transportation reflects a substantial increase in over-all marketing costs relative to over-all manufacturing costs. From the economic standpoint this constitutes the major challenge to marketing executives for the future application of logics to marketing. Moreover, and perhaps this is of even greater importance, it provides the basic explanation for the current severity of the conflict between the efforts of business to apply logics to marketing and the sentiments and emotions of masses of people.

It is pertinent to observe that the spear point of public and legislative interest in business seems to be directed at marketing activities to an extent greater than ever before. Business historians tell us that every major depression is accompanied and followed by increased public and legislative attention to business practices. In the present period that interest is to a great extent concentrated upon the marketing phases of business operations. The individual legislative enactments and proposals are not isolated events brought about in each instance by the efforts of a small group. On the contrary, they spring from a common source; and that common source is to be found not in business per se but in the impact of business developments upon the social organization and way of life of substantial numbers of people.

That marketing activities now bulk larger in our economic life than ever before means that there are large numbers of people personally affected by developments in marketing, that changes brought about by the applications of logic necessarily affect groups of people who are numerically important in the population. Moreover, the increased importance of marketing activities, or, as it is more frequently stated, the increased cost of distribution, has given rise to a number of active schools of thought as to the meaning of the development. One school constantly reiterates that the gains secured from technical improvements in manufacturing processes have been swallowed up by the increase in distribution costs. This reasoning leads to a host of proposals and suggestions for short-cutting the marketing process. A second school holds that the present expenditures on marketing are a prerequisite to large-scale manufacturing. Still another group points to the admitted fact that the satisfaction of consumers' wants increasingly involves providing not only merchandise but also services and conveniences. Regardless of the attitude which one assumes toward these and other possible interpretations of the increased costs of distribution, it is difficult not to conclude that as a nation we are undecided whether the development is sound or unsound, whether it is socially desirable or undesirable. Since the recent past has been the first major period of stress since marketing assumed its present importance, a substantial amount of legislative attention directed at marketing is a natural development.

But there are other forces operating to bring about political action in the marketing sphere more definite and tangible than the general uncertainty and uneasiness which have been mentioned. The application of the logic of specialization by individuals on particular functions, operating through the development of large-scale distributive enterprises, has exerted great force on at least two groups, namely, the small competitors of large-scale organization, and the employees of large-scale enterprises. In 1935 there were in the United States slightly more than 1,650,000 retail stores. Of this number only 127,482 stores were units of chains, and approximately 1,700 stores were independent but relatively large-scale enterprises of the department store type. This means that there were approximately 1,475,000 single-store independents. To be sure, since the average sales of these stores were very much smaller than the average for units of chains, the latter accounted for a greater proportion of the total sales volume than is indicated by the proportion of number of stores. But this is not the significant point. What is significant is that the impact of the improved merchandising methods of the large-scale retailers called forth two types of defensive reactions on the part of a numerically large and therefore politically powerful group. The first type of defensive reaction has already been mentioned, namely, the attempt to parallel the devices of the corporate chains through the organization of retailer-owned cooperatives and voluntary chains. This may be considered a natural reaction in the economic sphere; but in spite of the tremendous growth of the movement in recent years, it has apparently affected only a relatively small proportion of the independent retailers of the country. Presumably the independent merchants who have participated in these developments include the more progressive and more rational elements; but in a very real sense retailing, as practiced by a large proportion of the remaining independents, is analogous to subsistence farming. It is no more business than subsistence farming is business. H. G. Wells, in one of his earliest books, makes the point dramatically:

> A great proportion of small shopkeepers, for example, are people who have, through the inefficiency that comes from inadequate training and sheer aimlessness, or through improvements in machinery or the drift of trade, been thrown out of employment, and who set up in needless shops as a method of eking out the savings upon which they count. They contrive to make sixty or seventy per cent of their expenditure, the rest is drawn from the shrinking capital. Essentially their lives are failures, not the sharp and tragic failure of the labourer who gets out of work and starves, but a slow, chronic process of consecutive small losses which may end, if the individual is exceptionally fortunate, in an impoverished deathbed before actual bankruptcy or destitution supervenes. . . . Every year sees the melancholy procession towards

> petty bankruptcy and imprisonment for debt go on, and there is no statesmanship in us to avert it. Every issue of every trade journal has its four or five columns of abridged bankruptcy proceedings, nearly every item in which means the final collapse of another struggling family upon the resources of the community, and continually a fresh supply of superfluous artisans and shop assistants coming out of employment with savings or "help" from relations, of widows with a husband's insurance money, of the ill-trained sons of parsimonious fathers, replaces the fallen in the ill-equipped jerry-built shops that everywhere abound.[1]

Perhaps the picture is overdrawn, but studies of the mortality rate of retail stores confirm the tremendous frequency with which small capitals are consumed. Nor is there evidence that the growth of large-scale retailers has accelerated the mortality rate. The defensive reactions of the group to whom the operation of a retail store is a means of escape are extremely likely to take the form, not of rational, logical steps to meet the competition of large-scale enterprises, but of emotional antagonism and the desire to call forth a similar emotional antagonism on the part of relatives and friends. This has happened to a very considerable extent, and has provided the motivating force for the current wave of legislative enactments and proposals designed primarily to hamper large-scale enterprise. Moreover, the movement has impressive intellectual support. An important group, including at least two of the justices of the Supreme Court, are convinced of the necessity of protecting the position of the small business unit for the sake of social stability, for the sake of maintaining a way of escape for individuals. Technical developments in many manufacturing industries have made it extremely difficult to visualize maintenance of opportunity for small enterprises. With this in mind, distribution generally, and retailing in particular, is looked upon as the last stronghold of the small unit; and this group of thinkers are apparently prepared to go to considerable lengths to protect the last stronghold. Admittedly, the reasoning is not based on economic logic. In his opinion upholding the West Virginia chain store tax, Mr. Justice Cardozo, discussing the right of a state to tax large chains more heavily than small ones, said, "Not only may it do this, but it may make the tax so heavy as to discourage a multiplication of units to an extent believed to be inordinate and by the incidence of the burden develop other forms of industry. A motive to build up through legislation the quality of men may be as creditable in the thought of some as a motive to magnify the quantity of trade." Large-scale retailing has followed logic from an economic standpoint. In its relations with its small-scale competitors it has run head-on not only into logical economic opposition but also into emotional social opposition; and it is not impossible that the consequence of the latter collision will be much more serious than the consequences of the former collision.

The second group which has felt the impact of this logic is made up of the employees. The failure of management in manufacturing to establish with employees satisfactory relations founded on an understanding that the relationship is not only economic but also social, that the influences to which men and women react are not only the pay check but also the satisfactions to be drawn from human contacts involved in business, is currently receiving much attention. The failure on the part of management in marketing activities has been no less great than it has in manufacturing. The essential logics of large-scale retailing, namely, specialization of individuals on specific functions with consequent increase in skill in the performance of those functions, has been secured by minimizing the scope of activity of the great mass of employees and by the necessary impersonality in dealing with them. Inevitably the contacts with the great majority of the employees have been delegated to the lower supervisory ranks. Whether the problem could be solved even if senior executives devised some means for establishing contacts themselves is doubtful; but the actual fact has been that, when speaking frankly, the executives of many large-scale retail organizations freely admit that the weakest link in the chain is at the point of contact between the lower ranks of employees and their immediate supervisors.

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[1] H. G. Wells, *The History of Mr. Polly* (New York, Nelson, 1910), pp. 217–219.

There are several well-recognized difficulties which serve to impede the development of union organization by the employees of large-scale retail concerns. In the not too distant past there was a tendency for the managements of such organizations to rest complacently in the belief that these barriers could not be overcome. It is true that as yet the activities of organizers in the retail field represent no more than a skirmish line slowly advancing, but the recent skirmishes in Milwaukee, Cleveland, Philadelphia, Providence, and Detroit, all involving strikes in retail stores, are symptoms not to be regarded lightly. Already the retailers of several cities, including St. Paul, Omaha, and San Francisco, have negotiated far-reaching agreements with organizations of retail employees. Few clear-sighted retail executives are now certain that organization of retail employees is impossible. From this source comes another stream of emotional antagonism of which the legislator is perfectly aware.

The attempts to apply logics to marketing by the transfer and realignment of functions among different types of marketing institutions and by experiments with different types of merchandise have also left their mark. Inevitably such shifts leave some enterprises in difficult or untenable positions. Rapid change makes gradual adjustments on their part impossible and results in painful collapse. Moreover, the confusion resulting in the minds of businessmen is intensified in the minds of legislators. Rapid change, experimentation with the inevitable proportion of failures impress themselves on the minds of men primarily concerned not with economic but with social and political conditions as situations requiring the external application of regulative measures; and so we have a host of legislative enactments and proposals concerned with current marketing methods and procedures. Included among the enactments are drastic discriminatory taxes on chain stores, the Robinson-Patman Act, state and federal resale price maintenance legislation, and state statutes prohibiting sales below cost (cost defined in several different ways). Whatever the far-flung consequences of some of this legislation, there can be no question that its sponsors have envisioned it as designed to hamper and even to cripple large-scale enterprises, especially large-scale retail enterprises. The dictum of Congressman Patman, "Chain stores are out. There is no place for chain stores in the American economic picture,"[1] reflects the basic objective toward which such legislation is pointed in the minds of many of its sponsors. Much of the legislation cited, however, is indirect in moving toward this goal, and its effectiveness in handicapping large-scale enterprises is far from certain. Accordingly, new proposals for federal legislation are in incubation. Representative Patman expects to push two at the next session of Congress; the first provides that no concern shall operate units in more than a single state, and the second that there shall be no integration of manufacturing and retailing within the same concern. This is direct action with a vengeance. In view of the high degree of success of the lobbies of the militant faction of small retailers in the recent past, the increased confidence and membership gained by these organizations because of their legislative victories, and the widespread emotional antagonism toward big business, it is impossible to assert that these proposals in one form or another will not be enacted.

No specific course of action for executives charged with the responsibility for marketing activities is here suggested. A large share of the problems now current in the field have their roots in the emotional attitudes developed from the impact of past changes in marketing upon the economic and, more particularly, the social position of large numbers of people.

If this view be accepted, it follows that, when experiments in the application of logics to marketing are being conceived and executed, existing and potential emotional attitudes must receive vastly more attention than they have in the past.

EFFECTIVE GROCERY WHOLESALING

WHOLESALER-RETAILER RELATIONS

Far-reaching changes in the character of the wholesale grocery business have occurred during the lives of many still actively engaged in the trade. Many executives can remember when their firms purchased a year's or a season's supply of practically everything carried in stock; when they stored large quantities of merchandise for long periods; when high margins were the rule and stock appreciated in value before the next season's supply became available; and when the principal problems were those of obtaining, transporting, and financing sufficient supplies.

Technological developments in the factory and on the farm, improvements in transportation and in communication, and the easier availability of credit and capital now have greatly altered the nature of the wholesaler's functions. These developments have quickened the tempo and have changed the channels of food distribution. All of these factors have contributed to the movement of a much greater volume of goods and to an increase in the pressure to obtain retail outlets. It has become increasingly difficult for the grocery wholesaler to earn a profit merely by purchasing and storing large quantities of goods for long periods and selling in small lots.

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[1] Address to the annual convention of the United Independent Grocers and Food Dealers Association, New York, Apr. 11, 1937.

Source: U.S. Bureau of Foreign and Domestic Commerce, Economic Series No. 14 (Washington, D.C., U.S. Government Printing Office, 1941), Chap. I, pp. 15–27.

Wholesale grocers have been forced to adapt themselves to these changes. They have concerned themselves more and more with the merchandising of food through the retail stage of distribution to the consumer. By the establishment of closer relations between wholesaler and retailer (accomplished through the organization of voluntary groups, retailer-owned cooperatives, and through other means) the effectiveness of the merchandising of food to the consumer has been greatly increased. Also, the wholesaler has been able to improve the competitive position of the independent retailer and to make him a better customer. Finally, the degree of control which has been established over a selected group of retailers has permitted the wholesaler to perform a better job at lower expense. The latter accomplishment has been so significant that some alert wholesalers have boldly adopted a policy of selling only to profitable customers.

Brand and price policies are closely tied in with the wholesaler's new objective of merchandising food through the retail stage of distribution to the consumer. With competition forcing the trend toward lower gross margins per unit of merchandise, and with the leader merchandising principle firmly established in the food trade, wholesalers are increasingly turning toward the controlled brands as a means of obtaining sufficient dollar gross margin for both themselves and for their retail customers. The promotion of a line of controlled-brand goods, however, brings in its train a whole series of merchandising and operating problems. Not the least of these problems is the determination of the relative profitability of controlled and nationally advertised brands.

The wholesaler is inevitably led into the field of retail price suggestion through the integration of the wholesale and retail functions, through the wholesaler's effort to improve the competitive position of the retailer, and through his attempt to help the retailer secure a satisfactory dollar gross margin. The complexities of the wholesaler's pricing problems are thereby increased and his entire merchandising operations are affected.

All of these changes in the merchandising operations of the wholesale grocer have changed his selling job. Although the establishment of closer relations between wholesaler and retailer makes easier the task of selling merchandise to the retailer, the necessity of moving a larger volume of goods off the shelves of the retailer has increased the selling job of the wholesaler. Educating the retailer as to the best merchandising practices, and as to the most efficient operating methods, helping him with his pricing problems, and at the same time properly executing the firm's established price, brand, and credit policies has certainly placed an added burden on the wholesaler's salesmen.

. . . .

(Throughout this report each wholesale house is identified by a house number. These house numbers have no relation to size of business or type of operation. . . . Throughout the text the experiences, comments, and opinions of the individual wholesalers, expressed in their own words as nearly as possible, are followed by these same house numbers in parentheses.)

An increasing number of wholesalers, especially in metropolitan areas, are taking steps in a program designed to coordinate the complementary wholesale and retail functions. They are doing this by establishing closer relations with their retailers. In this chapter a number of instances are presented which illustrate the methods used by wholesale grocers in carrying out the principles of coordination.

While the old-line operator can coordinate these functions by selective selling . . . or by other means, more progress has been made by wholesale houses sponsoring voluntary groups or operating as retailer-owned cooperatives. The less tangible character of the coordination that is achieved informally by the old-line operators and the greater progress and the more tangible results of the voluntary-group operators and cooperatives suggest the wisdom of limiting this chapter to a discussion of the methods employed by the two latter groups.

What are the objectives that wholesalers seek in coordinating their operations with those of retailers? They may be enumerated as follows: first, to establish a degree of control over selected retailers in order that wholesale functions may be performed at lower expense; second, to improve the competitive position of the independent retailer to make him a more stable and profitable customer.

Wholesalers find that as a result of coordination they perform the wholesale functions at lower expense. In achieving the second objective, however, they find it necessary to undertake certain retail functions the cost of which may more than offset the reductions in expense achieved in the wholesale functions. What, then, is the net advantage of coordination? The following discussion shows that the net advantage of coordination lies in an improvement in the competitive position of the wholesaler-retailer combination.

CONCENTRATION OF PURCHASES AS A RESULT OF COORDINATION

One of the purposes of establishing coordination is to get retailers to concentrate their purchases with the wholesaler. The belief that concentration of purchases by retailers will enable the wholesaler to perform his functions at lower expense is based on the distribution-cost-analysis principle that customer (i.e., retailer) characteristics govern the dollar total of many of the items of wholesaler expense. For example, the wholesaler's expenses are less, per dollar of sales, when the average order is $100 rather than $10. When the retailer concentrates his purchases, becomes a steady full-line customer, and conforms to a regular schedule of sales calls and deliveries, he favorably affects certain expenses of the wholesaler.

Ample evidence was found that wholesalers are succeeding—in varying degrees, of course—in getting customers to concentrate their purchases. Table 1 shows the degree to which the concentration of retailer purchases has been achieved.

Larger annual sales to individual customers tend to follow coordination. Table 1 shows that houses selling predominantly to cooperative or voluntary-

TABLE I

RELATIONSHIP BETWEEN AVERAGE ANNUAL SALES PER CUSTOMER AND PREDOMINANT TYPE OF CUSTOMER, 1938

House No.	Average Annual Sales per Customer [a]	Proportion of Sales by Customer Type [b]					
		Owner-Members of the Cooperative Wholesale House		Independent Grocery Stores Affiliated with the Wholesaler As Members of the Voluntary Group		Independent Grocery Stores Not Affiliated with the Wholesale House	
		Percent, Number	Percent, Sales	Percent, Number	Percent, Sales	Percent, Number	Percent, Sales
1 [c]	$18,446	100	100				
78	10,440	98	[d]				
42	10,102	100	100				
89	10,084	...	...	100	100		
35	7,886	100	100				
16	7,864	92	97				
92	6,559	100	100				
82	6,488	100	100				
66 [e]	6,449	...	...	...	...	60	52
91	6,429	...	...	45	70		
81	6,364	...	...	100	100		
47	6,006	100	100				
87	5,967	100	100				
49	5,625	...	...	43	60		
55	5,285	100	100				
60	5,000	...	...	50	80		
29	4,394	...	...	34	85		
2	3,821	100	100				
38 [f]	3,697	...	...	...	...	70	65
26	3,405	...	...	30	75		
6	3,333	100	100				
33	3,333	...	...	33	70		
68 [g]	3,180	...	...	...	...	68	45
70	2,857	...	...	25	66		
27	2,769	...	...	28	75		
88	2,583	...	...	28	51		
14 [g]	2,574	...	...	...	...	91	75
22	2,500	...	...	28	79		
53	2,500	...	...	20	62		
58	2,400	...	...	...	...	94	85
51	2,381	...	...	...	...	95	90
7	2,369	70	75				
18	2,353	...	...	60	65		
30	2,152	...	...	...	...	50	[d]
79	2,120	100	100				
64	2,117	...	...	...	...	92	89
65	2,116	...	...	...	...	98	98
5 [g]	2,000	...	...	...	...	88	[d]
80 [g]	1,957	...	...	...	...	73	54
63	1,843	...	...	...	...	97	90

TABLE 1 (*Continued*)

RELATIONSHIP BETWEEN AVERAGE ANNUAL SALES PER CUSTOMER AND PREDOMINANT TYPE OF CUSTOMER, 1938

House No.	Average Annual Sales per Customer [a]	Proportion of Sales by Customer Type [b]					
		Owner-Members of the Cooperative Wholesale House		Independent Grocery Stores Affiliated with the Wholesaler As Members of the Voluntary Group		Independent Grocery Stores Not Affiliated with the Wholesale House	
		Percent, Number	Percent, Sales	Percent, Number	Percent, Sales	Percent, Number	Percent, Sales
10	$1,705	...	...	17	60		
21 [g]	1,667	...	...	...	...	67	36
73	1,667	...	...	...	...	72	75
83 [g]	1,667	...	...	...	...	83	65
34	1,610	...	...	9	60		
77	1,364	...	...	15	70		
52	1,347	...	...	...	...	50	[d]
4	1,333	...	...	...	...	60	60
57	1,317	...	...	...	...	80	
69	1,250	...	...	...	...	73	
56 [h]	1,109	...	...	...	...	97	[d]
84	918	...	...	...	...	93	[d]
67	909	...	...	...	...	75	60
46 [g]	889	...	...	...	...	82	40
76 [g]	722	...	...	...	...	58	38
54	663	...	...	...	...	93	90

[a] Total reported sales divided by total number of customers of all types.

[b] Figures shown in this table are those for the customer type accounting for a larger percentage of sales than any other customer type in that house. Institutions, industrials, and other types of customers are not shown because of small proportions of sales.

[c] Handles meats and produce as well as groceries.

[d] Data not reported.

[e] Serves a large general-store trade.

[f] Serves a group of supermarkets.

[g] Has a voluntary group.

[h] Has a large cash business.

group members have the largest annual per-customer sales, and that as the proportion of total sales made to members declines, so also do the annual per-customer sales.

Average sales to voluntary-group members are usually many times larger than those made to other customers of the house. Table 2 shows that average sales to voluntary-group members are from 2 to 13 times as large as those made to nonmember customers.[1]

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[1] While cooperatives also enjoy large average annual sales per customer, such comparisons as are here made for voluntary-group operators cannot be made for the cooperatives since their sales to other (than member) customers are characteristically negligible.

A sheaf of orders lay on the desk of one wholesaler when the investigator visited his house. In order to compare the average-order size of the members of his voluntary group with that of the customers who were not members, a random sample of these orders was taken. (See Table 3.) There were 19 orders from voluntary-group members in the pile. The average value of these orders was $108. The first 19 nonmember orders were counted off and compared with them. The average order for the latter group amounted to only $7. This experience in one house shows clearly that concentration of purchases by retailers, as a consequence of coordination, can result in greatly increased average-order size for the wholesaler.

TABLE 2

VOLUNTARY-GROUP WHOLESALERS: COMPARISONS BETWEEN AVERAGE ANNUAL SALES TO VOLUNTARY-GROUP MEMBERS AND TO OTHER RETAIL STORES, 1938

House No.	Average Annual Sales per Customer		Ratio of Average Annual Sales of Voluntary-Group Members to Those of Other Customers *
	Voluntary-Group Members	Other Retailers	
77	$ 6,367	$ 482	13.2
34	9,259	881	10.5
22	6,913	735	9.4
13	4,500	529	8.5
29	9,337	1,098	8.5
10	6,429	811	7.9
27	7,495	958	7.8
26	8,512	1,215	7.0
50	7,903	1,123	7.0
46	4,123	625	6.6
53	7,750	1,188	6.5
70	7,416	1,303	5.7
21	6,000	1,185	5.1
33	7,000	1,500	4.7
14	8,527	1,969	4.3
32	2,481	606	4.1
60	8,000	2,000	4.0
68	8,724	2,233	3.9
76	2,111	551	3.8
80	5,637	1,474	3.8
18	4,800	1,333	3.6
91	10,000	3,506	2.9
88	4,757	1,750	2.7
12	3,500	1,286	2.7
49	7,885	3,933	2.0

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* Column 1 divided by column 2; thus, average per-customer volume of voluntary-group members is from 2 to 13 times as large as when dealing with nonmember customers.

TABLE 3

COMPARISON OF THE RELATIVE SIZES OF VOLUNTARY-GROUP AND OTHER CUSTOMER ORDERS, HOUSE NO. 77

Order No.	Non-Member Orders	Voluntary-Group-Member Orders
1	$ 3.94	$ 131.23
2	5.61	153.60
3	5.19	187.39
4	14.29	89.45
5	15.58	136.83
6	4.97	37.37
7	13.08	87.03
8	5.30	101.31
9	2.40	45.00
10	3.46	290.73
11	18.25	81.74
12	6.30	92.38
13	3.19	110.32
14	1.35	65.62
15	9.13	165.48
16	0.63	76.19
17	7.00	86.93
18	3.00	68.16
19	11.00	51.86
Total..................	$133.67	$2,058.62
Average value per order...	7.04	108.35

HOW INDIVIDUAL WHOLESALERS ACHIEVE COORDINATION

There are several ways in which wholesalers, through coordination, seek concentration of purchases by retailers and achieve expense reduction. These are illustrated in the following cases:

About 15 years ago we decided that to continue in business we would have to select our customers, get them to concentrate their purchases, and consider the resulting combination as a single distribution unit. Instead of having salesmen call on as many accounts as possible, attempting to obtain orders from all and trying to unload on the retailers as much merchandise as possible, we decided it was necessary to operate along the now well-known voluntary-group lines.

Even today, in spite of all the progress that has been made, too many wholesalers think of themselves as wholesalers only. They're wrong—it's necessary to cement wholesaling and retailing into one operation. The combined costs of performing the two functions can then be reduced because operations can be more efficient all along the line—in buying, order assembly, warehousing, delivery, selling, and advertising—and more goods can be moved at lower prices. In our organization 90 percent of the thinking is from the viewpoint of "How will this affect the retailer?" We were pioneers in the voluntary-group movement. The changes we made took place gradually, and the process is still going on, from the viewpoint of selective selling.

Before becoming a voluntary we had wide distribution. A housewife could find our coffee in nine out of ten food stores in the city. We thought that was pretty

> good, until we had opportunity to check up with a large chain organization which also pushes coffee. We found that the chain sold only to their 200 stores, as against our 5,000, but they were doing a better job. They were selling more coffee than we were—and they were growing while we were declining. The chain was pushing its brand of coffee hard in its 200 stores while we spread our selling efforts among 5,000 outlets, most of which weren't pushing our coffee at all because they had no incentive. Obviously, the job for us was to concentrate.
>
> Another factor that helped us decide to concentrate our sales effort was that we noticed it was easier to get successful merchants to concentrate their purchases with us than it was to get the less successful ones to do so.
>
> Look at us now—once we had 5,000 actively solicited accounts; today we have only 700 to 750. The rest were dropped because they were unprofitable on the order-size basis. Our average order size now is about $100. Sales volume didn't decline as a result of this change, but there has been a sharp reduction in expense. These two results were what we sought when we entered the voluntary field. (91)

The experience of the above wholesaler shows that concentration of purchases by the retailer in response to advantages offered by the wholesaler results in larger average sales per customer and larger sales per salesman, with concomitant expense reduction.

The following quotation shows that concentration of purchases by the retailer also tends to bring about an increased stability in the inflow of business to the wholesale house, facilitating a better organization of work with resulting expense reduction. In the words of the wholesaler:

> The loyalty of our customers has made it possible to level off the peaks and valleys of sales volume and to predict what, how much, and when customers would purchase. We have been able to reduce expenses and to budget them in advance all the way through—in warehousing and order-assembly operations, in delivery operations, and in office and buying functions—and there is a steady, even flow of work. We know how much work we will have to handle, and all operations are so scheduled that the peak loads are low and temporary help is employed only in exceptional circumstances.
>
> Our gross margins are set to equal the estimated operating expenses; operating profit, if any, is refunded to retailers; and the wholesale profits are solely from cash discounts earned on purchases. With our prices based on costs, the retailers have a twofold interest in cooperating with us to keep costs low—first, because the lower our cost, the lower our prices; and, second, operating profits are refunded to the retailers. Because of the loyalty of our voluntary group, total operating expenses and gross margins were only 4.5 percent of sales in 1938, not including delivery expense. (81)

Another wholesaler who obtained 65 to 75 percent of his total volume from his voluntary group (which includes less than 30 percent of the total number of his customers) found that such a degree of sales concentration made it possible to reduce expenses all along the line. In his words:

> With this close tie-up there is never any question of quantities in buying goods. We know exactly what our merchants can absorb and we buy accordingly. I can gage and control my buying because these voluntary group members are steady, full-line, and consistently large buyers. I can take advantage of market conditions in buying. Those who have to sell on a catch-as-catch-can basis never know how much business they will do, while I know exactly.
>
> With this set-up I can control my inventory and use space and labor in such a way as to make it possible to keep expenses down. My salesmen obtain large sales

> per order. My trucks have large orders per delivery. For instance—one of my salesmen who works only two days a week and calls on 29 of my voluntary members consistently outsells another who works a full week and calls on 150 nonmembers. (18)

The close relationship between this wholesaler and the members of his voluntary group enabled him to achieve substantial operating efficiencies which made it possible to sell at low prices and, at the same time, to operate at a profit. The firm operates at an expense ratio of from 5 to 6 percent, and, the manager stated, "We always make money."

Another wholesaler coordinated the wholesale and retail functions to reach his objective of "eliminating" salesmen. He replaced them with "a few merchandising supervisors" to maintain contact with his retailers. He stated:

> We used to employ 40 salesmen, at high expense. So we held a meeting of our dealers and explained a plan to eliminate all personal order taking. All orders would be solicited through the mail. Instead of salesmen we would then employ a few merchandising supervisors who would not solicit orders but who would work closely with merchants to help them improve their businesses by means of better display, better store and stock arrangement, and by checking up on mark-ups, advertising, and promotion methods.
>
> Because of the reduced selling expense that we felt we could expect, retailers would share in our profits. We agreed to allow them a dividend of 10 percent of our gross profit on their purchases. There would be a list of standard prices, and instead of reducing our prices on special sales events, we would pay the retailer an additional special merchandising dividend of 3 to 15 cents per case for his efforts in pushing the special items.
>
> These dividends were to be credited to a special dividend account of the retailer until a credit of $300 accumulated as a pledge against his account. Then, cash payments in excess of $300 were to be paid semiannually. The plan was adopted and has worked well. In the last 2½ years $84,000 has been distributed in dividends, some semiannual checks amounting to as much as $500. These methods have reduced our selling expense and increased the purchases of our retailers. There is now $118,000 of their money on deposit with us as a pledge against accounts receivable. Any time a retailer wants to leave the group he can draw out his balance after we deduct what he owes us. (89)

A cooperative wholesale house which started as a buying organization of only 23 members now has over 400 members, and has never employed salesmen, contact men, or supervisors, pays no commissions for obtaining new members, and has no direct selling expenses for obtaining orders. A description of how the organization sold itself to its present members follows:

> In most cases our new members are recommended by present ones, or have taken the initiative themselves in becoming members. Sometimes our officials use spare time to interview worth while prospective customers, but there is no one in the organization who specially solicits members or orders.
>
> All selling is accomplished through weekly bulletins. These notify our retailers of our specials, price changes, new merchandise, new merchandising helps and ideas, and all other information which most wholesalers handle through personal contact.
>
> Credit is handled by our officers with a minimum of direct customer contact. All bills must be paid weekly and if a member's delinquency amounts to $300, which is the amount of his stock in the cooperative, his account is closed and he can make no more purchases until he pays up—not even on a c.o.d. basis—unless he makes

> some payment on his old account. Contacts necessary in connection with collections are made by our officers by telephone, mail, or, in rare instances, in person.
>
> Our only real personal contact with retailers is at our monthly meetings, when special displays of new merchandise are shown and seasonal goods and merchandising ideas are brought to the attention of members. At these meetings no orders are solicited—but, of course, they are accepted if offered. We also keep an idea book along merchandising lines for the use of members.
>
> We operate successfully without using salesmen or contact men because the retailers have confidence in us—and we maintain that confidence. When an item is listed in the bulletin as a "good buy" the retailers are "sold" because we never try to "pull a fast one" on them. Personal selling may be more effective than any other form, but the results we get from this method lead us to feel that the expense of contact men wouldn't be justified by the additional sales volume obtainable. (82)

As a consequence of operating without a sales force and without delivery—although credit is extended—the above wholesaler's operating expense ratios have ranged from 3.85 to 4.90 percent of sales.

It isn't easy to obtain a high degree of control over retailers, despite the advantages of coordination. Retailers wish to retain their independence. Various methods have been employed by voluntary-group and cooperative houses to hold retailers more closely in the organization. One voluntary-group operator (18) had his members elect a committee of 20 with which he can consult when difficulties arise.

He delegates to this committee the responsibility of many important tasks in the field of customer control and customer relations. He places advertising allowances received from manufacturers in a separate bank account under the control of the committee. This committee plans all advertising expenditures, selects the articles to be featured, sets the retail prices to be published, arranges the advertising copy, and selects the advertising media—drawing its own checks to pay for expenditures. The amount received from advertising allowances pays for the advertising services rendered. Under this committee arrangement the wholesaler cannot be accused of profiting at the expense of his merchants.

The committee also "supervises" the merchants, each committeeman being responsible for adherence to policy of five or six members of the voluntary group. For example, when it is decided to take on new lines, the committee urges the members to push the new goods. The wholesaler suggests resale prices to the retailers and the committeemen see that these prices are put into effect. As a result, said the manager:

> We are not undersold by the supermarkets or by chain stores on comparable qualities of goods. We attribute part of this advantage to the action of the committee. It doesn't hesitate to do what we would find it impossible to do. In general, it acts as a means of bringing all the members into line for the common good. (18)

The preceding cases thus show that coordination permits reduced operating expense in performing the following functions:

1. Buying—because the wholesaler can be assured of an outlet for his goods. He knows what, when, and how much the retailers will buy.
2. Warehousing and delivery—because the wholesaler knows the nature, amount, and frequency of retailers' orders, and plans operations accordingly.

3. Selling—because the effort to sell merchandise tends to be reduced by effective coordination.
4. Office—because the expense of the office processes tends to depend largely on the number of invoice lines, which under coordination are increased in value. The burden of office work is steadied, and can be better organized.

Effect of Coordination on the Competitive Position of the Wholesaler and Retailer

Reduced wholesale expense permits the wholesaler to quote lower prices to retailers and this, in turn, permits lower retail prices, placing the wholesaler-retailer combination in a better competitive position. The services of advertising, merchandising counsel, accounting, store lay-out, gross-margin management, cooperative equipment purchasing, and other services that the individual retailer could not economically provide for himself are provided by the wholesaler. These enable the wholesaler-retailer combination to increase sales volume, and generally to improve the retail merchandising job.

It is emphasized that this view of wholesaling and retailing as complementary functions greatly changes the nature of the merchandising efforts of both the wholesaler and retailer. Figure 1 illustrates these effects of coordination on the merchandising efforts of both wholesaler and retailer. Coordination reduces the selling effort of the wholesaler and the buying effort of the re-

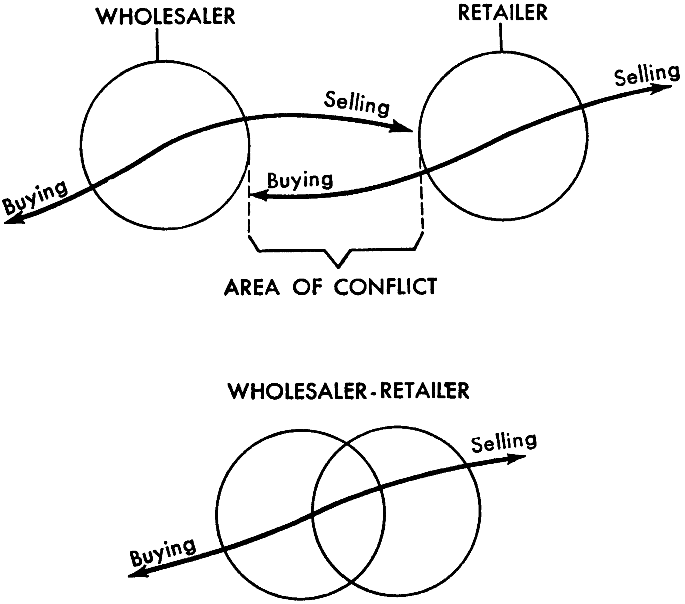

Figure 1. Wholesaler-retailer relations before and after coordination of functions.

tailer. It permits the wholesaler to concentrate on buying and the retailer to concentrate on selling. The many services which the wholesaler renders to the retailers (mentioned in the paragraph above) facilitate an unimpeded flow of goods to the consumer. . . .

EFFECT OF COORDINATION UPON THE EXPENSE OF THE WHOLESALING AND RETAILING FUNCTIONS

There is strong theoretical justification for the wholesaler's belief that it is the customer characteristics that influence the amounts of many of the wholesaler's expenses. Distribution cost analysis methods developed by the Department of Commerce have strengthened that point. No statistical evidence was found in this survey, however, indicating that coordination results in a lowered total wholesale expense. On the contrary, in the limited sample covered by this survey and in the Census data it has been found that voluntary-group operators have higher total-expense ratios than "old-line" operators. (See Table 4.)

TABLE 4

AVERAGE EXPENSE RATIOS OF THREE TYPES OF GROCERY WHOLESALERS, 1938 AND 1939

Type of Operation	Number of Establishments Included		Operating Expenses Percent of Sales [†]	
	Census 1939 [*]	This Survey 1938–39	Census 1939 [*]	This Survey 1938–39
Not sponsoring cooperative or voluntary groups (old-line)....	2,786	25	9.6	9.77
Voluntary-group wholesalers....	638	14	10.6	10.17
Retailer-owned cooperatives.....	136	13	5.2	6.14

[*] U.S. Bureau of the Census, *Sixteenth Census of the United States, 1940, Wholesale Trade: 1939,* "United States Summary" (Washington, D.C., U.S. Government Printing Office, Mar. 31, 1941), Table 1, p. 6.

[†] Caution is required in attempting to compare the results obtained in this survey with those of the Census, shown in the table. In the first place, operating expense ratios were obtained by the Census by dividing total dollar operating expenses by total dollar sales for all establishments. In this survey, because dollar figures were not available in all cases, the operating ratios shown in the table are averages of percentage ratios; thus, the averages are weighted by number of houses rather than by volume, as in the Census. Secondly, the Census includes as voluntary-group operators all wholesalers having such members regardless of the proportion of business accounted for by the voluntary-group members. For purposes of this report, however, voluntary group operators are defined as those who obtained 40 percent or more of their sales from members of their group. Those obtaining less than 40 percent of their volume from the voluntary group are classified with the "old-line" wholesale merchants.

The average operating expense ratios of the old-line and retailer-owned cooperative houses included in this survey are higher than those of the Census. In some part, this is due to the different years and to the above statistical differences as well as to differences in method of reporting operating expenses. Another factor is the probably higher proportion of controlled-brand operators included in this survey than in the trade at large.

The fact that the retailer-owned cooperatives, with highly integrated wholesale and retail functions, have lower expenses than either the voluntary-group or old-line merchants does not prove the case for integration. Characteristically, cooperatives render less service than either of the other types of operation, many cooperatives being wholly cash-and-carry houses. The Census reports that:

> . . . by rendering a minimum of service, cooperative warehouses can be operated at extremely low costs, but when . . . numerous functions such as granting credit and delivering are added, total expenses of the few houses (which do so) approximate those of service wholesalers.[1]

TABLE 5

RANGE OF OPERATING EXPENSE RATIOS FOR THREE TYPES OF WHOLESALE GROCERY OPERATION, 1938

Cooperatives *		Voluntary-Group Houses †		Others ‡	
House No.	Expense Ratio	House No.	Expense Ratio	House No.	Expense Ratio
42	3.77	43	6.97	64	6.36
2	4.25	49	7.87	44	6.93
24	4.64	29	8.56	5	7.10
82	4.90	59	8.97	8	7.86
47	5.32	68	8.99 §	76	8.21
16	5.66	22	9.46	61	8.23
78	5.95 §	27	10.08	50	8.43
1	6.66	13	9.50	56	8.45
35	6.56	77	11.09	80	8.92
7	6.95	91	11.32	63	9.03
92	7.49	26	10.64	65	9.06
79	8.52 §	88	11.55	52	9.80
87	9.11	70	13.01	72	9.82
		32	14.40	14	9.84
				30	9.87
				12	10.18
				71	10.72 §
				21	11.11
				46	11.14
				67	11.19 §
				84	11.31
				31	10.97
				36	12.34
				66	12.85
				57	14.59
Average ‖	6.14	Average ‖	10.17	Average ‖	9.77

* Cooperatives—Houses selling only to members, in most cases.

† Voluntaries—Houses with 40 percent or more of the sales volume made to members of voluntary groups.

‡ Others—Old-line houses and those whose voluntary-group sales account for less than 40 percent of total sales.

§ Fiscal year ended June 30, 1939.

‖ Arithmetic mean of operating ratios.

Are voluntary-group operators and others mistaken, then, in their belief that coordination of wholesaling and retailing favorably affects the expenses of the wholesaler?

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[1] U.S. Bureau of the Census, *Sixteenth Census of the United States, 1940, Wholesale Trade: 1939,* "United States Summary" (Washington, D.C., U.S. Government Printing Office, Mar. 31, 1941), p. 22.

The divergence between the claims of individual firms and the statistics for the trade at large is due to several factors. The over-all statistics are in terms of averages which conceal wide dispersion of individual cases. (See Table 5, showing ranges of operating expense ratios by types of operation in the present survey.)

There are important differences between wholesale houses that sell mainly to voluntary groups and others that are essentially old-line operators, but which have a small voluntary group from which about 10 percent of their business is obtained. It is only in the former class of wholesalers that coördination can have an appreciable effect on operating expenses, and this result is indicated by the statistics. Table 6 (from the 1935 Census) shows that operating expenses decrease as the proportion of sales to voluntary-group members increases.

TABLE 6

OPERATING EXPENSES OF VOLUNTARY-GROUP WHOLESALE GROCERS AS AFFECTED BY PROPORTIONS OF SALES TO VOLUNTARY-GROUP MEMBERS, 1935

Percentage of Total Sales to Voluntary-Group Members	Number of Establishments	Operating Expense as a Percentage of Sales
Less than 10 percent.......	26	11.3
10–30 percent.............	157	11.5
30–50 percent.............	157	9.9
50–70 percent.............	116	9.4
70–90 percent.............	61	9.3
90 percent or more.........	30	8.3
All voluntaries..........	547	10.3

Source: U.S. Bureau of the Census, *Census of Business, 1935, Voluntary-Group and Cooperative Wholesalers—Groceries and Related Products* (Washington, D.C., U.S. Government Printing Office), Table 4, p. 19.

Only 30 out of a total of 547 voluntary-group operators in the entire country (1935) succeeded in obtaining 90 percent or more of their sales from voluntary-group members. This illustrates the difficulties that lie in the way of completely coordinating the wholesale and retail functions. It is significant that these 30 houses had the lowest average operating-expense ratio of all voluntary-group operators. For these 30 houses the ratio was 8.3 percent, or two percentage points lower than the average ratio for all voluntary-group operators (10.3) and three percentage points lower than that of operators obtaining less then 10 percent of their volume from voluntary-group customers (11.3). This evidence bears out the fact that voluntary-group operators do reduce their expenses as they obtain larger proportions of their business from the members of the voluntary group.

In coordinating wholesale and retail operations there is a favorable influence on the expense of performing the wholesaling functions, but in aiding the retailer the usual functions of the wholesaler are changed and new functions are added. The wholesaler often dispenses with "salesmen" if he organizes a voluntary group and sells only to members of this group—but in their stead he employs "supervisors" (whose primary function is to help retailers improve their efficiency). If the wholesaler sells both to members of the voluntary group and other independent retailers, salesmen are still necessary, as well as supervisors. The resulting net effect upon the wholesaler's selling expenses is difficult to determine and may be indeterminable.

However, as sales to the voluntary group become a larger proportion of the wholesaler's total volume there is usually an appreciable increase in the volume of sales per sales call and a reduction in the total number of sales calls. Census data (1935) reveal a steady decrease in the number of salesmen per $1,000,000 of sales among the voluntary-group operators as the proportion of sales to members increases (see Table 7). Thus through coordination there is a reduction in the cost of the wholesale function of selling.

TABLE 7

NUMBER OF SALESMEN OF VOLUNTARY-GROUP WHOLESALE GROCERS AS AFFECTED BY PROPORTIONS OF SALES TO VOLUNTARY-GROUP MEMBERS, 1935

Percentage of Total Sales to Voluntary-Group Members	Number of Salesmen per $1,000,000 of Sales
Less than 10 percent	10.7
10–30 percent	10.0
30–50 percent	7.8
50–70 percent	7.3
70–90 percent	6.5
90 percent or more	3.9
All voluntaries	8.3

Source: U.S. Bureau of the Census, *Census of Business, 1935, Voluntary Group and Cooperative Wholesalers—Groceries and Related Products* (Washington, D.C., U.S. Government Printing Office), Table 4, p. 19.

The distinction between wholesaling and retailing functions is clearly seen in the case of other (than selling) functions which the wholesaler undertakes in achieving coordination. Some voluntary-group and cooperative wholesalers employ accountants who install retail accounting systems and help retailers operate them; others even keep the retailers' books themselves and prepare monthly operating statements on the basis of daily reports furnished by the retailers. It is also common for wholesalers to prepare newspaper advertising, handbills, and window posters for the sponsored group of retailers. One of the wholesalers interviewed in this survey employed an architect whose function was to prepare plans for retail-store modernization, interior lay-out, and display.

All these functions are clearly retail (rather than wholesale) functions, and their cost is not always passed on to the benefiting retailers in the form of membership fees and dues.[1]

In consequence, many voluntary-group wholesale houses that perform retail functions for the voluntary group may show on their operating statement a total expense ratio higher than the average for old-line operations. It may be possible to segregate some of the wholesalers' expense items that are clearly chargeable to retail functions. By an examination of the operating statement in the case of one wholesaler (14) it was found that out of a total operating-expense ratio of 9.8 percent, 1.2 percentage points could be attributed to the cost of the retail functions undertaken in sponsoring his voluntary group. In most cases, however, it is not possible to separate the wholesale from the retail expenses, except by a detailed reexamination of the wholesaler's original sources of entry to his accounts. Thus, in order to state the true effects of coordination upon the level of operating expenses it is necessary to consider the effect upon the combined expense of wholesaling and retailing. The problem is difficult and offers an interesting field for investigation. It cannot be solved with the data available in this study, which are confined to wholesaling only.

There is, however, a strong presumption—based on the experience of individual wholesalers and the implications of Census statistics—that coordination does make it possible to reduce the expense of performing wholesale functions. Quite aside from any possible expense reductions, however, coordination has other advantages. Wholesalers and retailers find that, as a practical matter, they have greatly strengthened their competitive position through coordination. They believe that they have increased their sales volume over what it would have been otherwise. As a consequence they believe that, regardless of the level of total expense as a percentage of sales, they have also increased their dollar net profits.

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[1] Such income may or may not exceed the expense of performing these functions. The practices of wholesalers in their own accounting for these additional functions are varied, and the expense and income of these functions may or may not be segregated in the wholesaler's accounts. It is typical that they are mixed and the wholesaler himself may know only the direct expense of performing these retail functions—with many overhead expenses, applicable to both wholesaling and retailing, unsegregated.

DEPARTMENT STORE AND VARIETY CHAIN COSTS AND PROFITS

OPERATING RESULTS OF DEPARTMENT STORES IN 1946

1946 Highlights

Department store sales and final dollar earnings in 1946 broke all previous records. In the first full postwar year the surge of consumer spending carried department store dollar volume to a level two and a half times as high as in 1939 and a quarter greater than in the immediately preceding year 1945. Nevertheless the increase in department store earnings in 1946 was attributable not so much to the sharply augmented dollar sales volume as to the lifting of the excess profits tax.

For the fourth year in succession the gross margin percentage declined, falling off by a greater proportion than in the three preceding years put together. The lower gross margin percentage stemmed both from lower initial markon and from more drastic markdowns. Notwithstanding the sharp spurt in dollar sales volume the outlay of expense dollars more than kept pace, with the result that the total expense percentage crept up fractionally for the second successive year. The scissors-like action of lower gross margin and higher total expense trimmed down considerably the percentage of net gain before taxes from the markedly high figures of the preceding three years, reducing this percentage in fact to the lowest point since 1941. But the reduction in the Federal tax burden, because of the ending of the excess profits tax, cut the Government's levy on department store profits nearly in half; and, as a result, the final dollar earnings in 1946 surpassed all previous records, both in total and in percentage of sales.

The year 1946 in the department store field was characterized also by sharply rising inventories and a slightly diminishing rapidity of stock-turn, factors which, in conjunction with heavy year-end markdowns, augured the probability of notably less spectacular earnings in 1947.

The foregoing general conclusions, together with the other findings in this report, grow out of the analysis of the operating results of 399 firms conducting 500 department stores in the United States and Canada, with net sales of over $3,280,000,000 in 1946. . . . Table 1 . . . presents trends of the general average results for all department stores reporting for each of the twelve years, 1935–1946. . . . Table 5 . . . presents common figures for the fourteen natural divisions of total expense for the eleven volume groups, and also com-

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Sources: Harvard Business School, Bureau of Business Research, Bulletin No. 126, *Operating Results of Department and Specialty Stores in 1946*, by Malcolm P. McNair, pp. 1–4, 13–14; and Bulletin No. 127, *Expenses and Profits of Limited Price Variety Stores in 1946: Chains and Independents*, by Elizabeth A. Burnham, pp. vi, 1–2, 7, 32. Copyright, 1947, by the President and Fellows of Harvard College. Reproduced by permission.

TABLE I

GENERAL AVERAGES FOR DEPARTMENT STORES: 1935–1946

Groups and Items	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946
Number of reports	459	394	458	430	428	429	407	368	366	372	398	399
Year-to-year change in sales	105.0	111.8	104.4	92.9	105.4	106.4	117.4	112.4	116.3	112.3	111.5	125.4
Index of change in sales (1939 = 100)	87.5	97.8	102.1	94.9	100.0	106.4	124.9	140.4	163.3	183.4	204.4	256.3
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross margin	35.9	36.5	36.4	36.4	36.9	36.95	38.2	38.7	38.4	37.9	37.6	35.9
Total payroll	17.95%	17.4%	17.9%	18.3%	17.8%	17.55%	17.3%	16.75%	15.7%	15.0%	15.4%	15.9%
Real estate costs †	4.7	4.3	4.2	4.65	4.35	4.15	3.65	3.35	2.9	2.6	2.5	2.15
Advertising	3.8	3.65	3.65	3.75	3.6	3.5	3.15	2.7	2.4	2.2	2.2	2.25
All other expense †	8.45	8.55	9.25	9.7	9.65	9.55	9.3	8.4	7.7	7.6	7.75	7.8
Total expense †	34.9%	33.9%	35.0%	36.4%	35.4%	34.75%	33.4%	31.2%	28.7%	27.4%	27.85%	28.1%
Net profit or loss †	1.0%	2.6%	1.4%	0.0%	1.5%	2.2%	4.8%	7.5%	9.7%	10.5%	9.75%	7.8%
Net other income †	2.4	2.3	2.5	2.6	2.5	2.55	2.5	2.25	1.7	1.8	1.75	1.8
Net gain or loss before federal taxes on income	3.4%	4.9%	3.9%	2.6%	4.0%	4.75%	7.3%	9.75%	11.4%	12.3%	11.5%	9.6%
Federal taxes on income and excess profits	0.45	0.8	0.65	0.45	0.65	1.1	3.2	6.1 *	7.7 *	8.7 *	7.9 *	3.7
Net gain or loss after federal taxes on income	2.95%	4.1%	3.25%	2.15%	3.35%	3.65%	4.1%	3.65 *	3.7% *	3.6% *	3.6% *	5.9%
Returns and allowances	11.25%	11.8%	11.75%	11.45%	11.4%	11.75%	11.35%	9.6%	7.95%	7.0%	7.5%	8.7%
Total retail reductions	8.0%	7.05%	7.35%	7.7%	7.1%	6.85%	5.9%	5.55%	5.2%	5.3%	5.6%	6.85%
Rate of stock-turn ‡	4.2	4.4	4.1	4.1	4.3	4.4	4.3	3.55	4.6	4.95	5.4	5.25

* For the years 1943, 1944, and 1945, figures for Federal taxes on income and excess profits are shown net of the 10% postwar refund and debt retirement credit on excess profits taxes. For 1942, however, firms were not requested to provide details on such credits; hence, taxes for 1942 may have been reported before such deductions by some firms.

† Figures for these items have been revised for the years 1935–1945 for comparability with the 1946 results to reflect the change to 4% in the rate of interest charged on selected assets.

‡ Times a year, based on average monthly inventories.

mon figures for total expense classified on a functional basis for the six volume groups with sales over $1,000,000.

The following summary brings together the most important findings in this report with respect to department store performance in 1946.

SALES

1. The stores reporting to the Harvard Bureau for 1946 made total net sales 25% higher than in 1945. This figure, comparable with the Controllers' Congress rate of increase of 23%[1] and the Federal Reserve Index of 27%,[2] was the largest annual percentage increase on record for the department store business since the inception of these studies.

2. This sales increase was registered both in number of transactions, which moved up nearly 9%, and in the size of the average sale, which increased from $3.30 to $3.89, both of these being the sharpest advances on record since these rising trends first appeared in 1939.

3. In a marked reversal of the trends which had developed during the wartime years, cash sales typically dropped from 54.1% to 46.7% of the total, regular charge sales mounted from 35.7% to 41.4%, and C.O.D. and installment sales both increased.

4. Above the $2,000,000 mark, rates of sales increases were somewhat greater than below that point, the largest percentage being exhibited by stores with sales above $45,000,000, whereas the lowest rate of sales increase appeared for stores with sales under $150,000. (It should be remembered, however, that the large volume groups are much more representative than the smaller ones.) This predominance of higher sales gains among the larger stores, though less pronounced than in 1945, contrasts sharply with the situation in 1943, when the smaller stores obtained the greatest percentage increases.

5. Although there were some substantial variations in the rates of increase reported for different geographic areas and cities, these variations were less marked than during the war years. The tide of postwar inflationary spending swelled up throughout the nation at a fairly uniform level, with only a few exceptions.

6. For the fourth successive year main store sales advanced more rapidly than basement sales, though the difference was less pronounced than in 1943 when this divergence in favor of main store sales first appeared.

7. The most significant change in sales classified according to merchandise lines appeared, as might be expected, in the home furnishings division, which increased its share of total sales in main store owned departments from 17.6%

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[1] National Retail Dry Goods Association, Controllers' Congress, *1946 Departmental Merchandising and Operating Results of Department Stores and Specialty Stores* (New York, 1947), p. 7.

[2] Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, March, 1947, p. 320. The published Federal Reserve Index is based on calendar year data. It would remain unchanged, however, if it were converted to the fiscal year basis (12 months ended January 31) followed by the majority of department stores reporting to the Harvard Bureau and the Controllers' Congress. . . .

TABLE 5

COMMON FIGURES FOR EXPENSE BY NATURAL AND FUNCTIONAL DIVISIONS FOR DEPARTMENT STORES, 1946

(Net sales = 100%)

Items	Net Sales (in thousands)										
	Less Than $150	$150–300	$300–500	$500–750	$750–1,000	$1,000–2,000	$2,000–4,000	$4,000–10,000	$10,000–20,000	$20,000–45,000	$45,000 or More
Number of reports:											
Giving functional data	0	0	0	0	2	41 ‡	37 ‡	67 ‡	44 ‡	28 ‡	14 ‡
Giving other data	33 ‡	32 ‡	24 ‡	28	28 ‡	56 ‡	41 ‡	69 ‡	46 ‡	28 ‡	14 ‡
Aggregate sales (in thousands)	$3,284	$10,437	$9,153	$16,540	$23,151	$119,826	$105,120	$447,661	$646,378	$863,593	$1,039,186
Typical net sales (in thousands)	$ 105	$ 235	$ 380	$ 590	$ 830	$ 1,320	$ 2,500	$ 5,600	$ 13,500	$ 30,000	$ 60,000
Index of change in											
Sales (1946/1945)	111.0	116.5	121.0	117.0	117.0	121.0	123.5	122.7	124.2	126.5	127.5
Total expense (1946/1945)	*	*	*	*	*	115.5 †	121.0	121.5	126.0	127.5	127.5
Total payroll (1946/1945)	*	*	*	119.0	119.5 †	118.0	122.5	125.0	129.0	130.5	129.0
Population of city (in thousands)	5	9	16	25	25	40	65	170	450	600	2,000
Population (interquartile range—in thousands)	3–8	5–18	10–34	17–45	12–37	25–69	45–101	84–293	288–663	368–816	1,504–3,397
Natural divisions:											
Total payroll	13.4%	13.1%	14.5%	14.8%	14.8%	15.4%	15.4%	15.5%	15.95%	16.5%	15.75%
Real estate costs	1.8	1.8	1.8	2.8	2.1	2.45	2.0	2.6	2.35	2.0	2.0
Newspaper advertising	*	*	*	1.3 †	1.2 †	1.75	1.7	1.85	2.15	1.65	1.65
Direct advertising	*	*	*	0.4 †	0.6 †	0.1 †	0.05 †	0.05	0.15	0.15	0.15
Radio advertising	*	*	*			0.15 †	0.1 †	0.15 †	0.15	0.1	0.1
Other advertising	*	*	*			0.2 †	0.15 †	0.2	0.25	0.3	0.25
Total advertising (subtotal)	1.0	1.05	1.4	(1.7)	(1.8)	(2.2)	(2.0)	(2.25)	(2.7)	(2.2)	(2.15)
Taxes	0.45	0.55	0.6	0.6	0.65	0.7	0.75	0.75	0.8	0.75	0.85
Interest §	0.9	0.85	0.85	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.75
Supplies	0.75	0.65	0.9	0.9	1.05	1.1	1.3	1.45	1.55	1.5	1.4
Service purchased	0.6	0.45	0.6	0.55	0.5	0.6	0.55	0.6	0.85	0.8	1.1
Losses from bad debts	0.05 †	0.05	0.05 †	0.1	0.1	0.15	0.1	0.1	0.15	0.15	0.2
Other unclassified	0.65 †	0.6	0.7	0.75	0.7	1.15	1.0	1.1	1.3	1.6	1.65
Traveling	0.55	0.35	0.4	0.55	0.5	0.5	0.4	0.45	0.4	0.45	0.2
Communication	0.2	0.2	0.25	0.3	0.3	0.35	0.3	0.3	0.35	0.35	0.3
Repairs	0.2 †	0.2	0.3	0.3	0.3	0.5	0.5	0.6	0.7	0.65	0.7

Insurance §	0.3	0.35	0.4	0.3	0.3	0.35	0.25	0.25	0.2	0.15	0.15
Depreciation §	0.25	0.15	0.3	0.2	0.2	0.3	0.25	0.3	0.25	0.35	0.25
Professional services	0.1 †	0.15 †	0.25 †	0.35	0.4	0.55	0.4	0.45	0.45	0.55	0.55
Total expense	21.2%	20.5%	23.3%	24.9%	24.5%	27.1%	26.0%	27.5%	28.8%	28.8%	28.0%
Functional divisions: ‖											
Administrative and general:											
Accounting office, accounts receivable, and credit						2.1% †	2.0% †	1.95%	2.0%	1.9%	1.8%
Executive and other administrative and general						4.7 †	4.4 †	4.25	4.2	4.65	4.4
Total administrative and general						6.8%	6.4%	6.2%	6.2%	6.55%	6.2%
Occupancy:											
Operating and housekeeping						1.5%	1.6%	1.6%	1.85%	1.9%	2.05%
Real estate costs						2.45	2.0	2.6	2.35	2.0	2.0
Fixtures and equipment costs						0.4	0.35	0.35	0.35	0.45	0.3
Heat, light, and power						0.5	0.45	0.4	0.4	0.35	0.35
Total occupancy						4.85%	4.4%	4.95%	4.95%	4.7%	4.7%
Publicity:											
Sales promotion and general advertising						2.9%	2.45%	3.0%	3.45%	2.8%	2.7%
Display						0.55	0.6	0.55	0.55	0.5	0.45
Total publicity						3.45%	3.05%	3.55%	4.0%	3.3%	3.15%
Buying and merchandising:											
Merchandise management and buying						3.45%†	3.35%	3.55%	3.75%	3.75%	3.2%
Receiving and marking						0.45	0.45	0.55	0.55	0.6	0.5
Total buying and merchandising						3.9%	3.8%	4.1%	4.3%	4.35%	3.7%
Direct and general selling						7.75%	7.75%	8.0%	8.3%	8.9%	8.8%
Delivery						0.35	0.6	0.7	1.05	1.0	1.45
Total expense						27.1%	26.0%	27.5%	28.8%	28.8%	28.0%

* Data not available.

† Usable figures for this item were given on less than 75% of the reports.

‡ Some of the reports covered the operations of more than one store. In such cases, the population of the city in which the main store was located was used in preparing the figures for population.

§ Except on real estate.

‖ Firms with sales of less than $1,000,000 were not requested to report functional data.

to 22.1%. As in previous years, large stores typically had a greater proportion of net sales in home furnishings and in smallwares, toilet goods, notions, and novelties than did small stores.

8. Leased departments were more prominent in middle-size stores than in either small or large establishments. They manifested no clear tendency toward increased importance.

9. For the second successive year the percentage of merchandise returned by customers for credit moved up, this time at an accelerated pace, though the common figure of 8.7% of net sales still remained well below prewar levels. As usual, the returned goods ratios were notably higher for large stores.

Gross Margin

1. The over-all average for gross margin fell from 37.6% to 35.9%, a greater decline than the cumulative drop of the preceding three years. Since the peak in 1942, gross margin has receded by 2.8% of sales.

2. In every volume classification for which figures were available, the initial markon percentage commonly was lower in 1946 than in 1945, and at the same time total retail reductions were higher, usually by an amount ranging from 1% to 1.5% of net sales. Both factors affected gross margin adversely, but the decline in the gross margin percentage was caused more by increased markdowns than by lowered markons.

3. Characteristically stores in the lower volume groups reported lower gross margin percentages than the large stores. From $1,000,000 up in volume, the common figures for gross margin ranged only from 35.2% to 36.2%, the latter figure appearing for all three of the volume groups lying between $4,000,000 and $45,000,000.

Inventory and Stock-turn

1. The year 1946 witnessed a remarkable change in the inventory situation in department stores. Beginning the year with greatly depleted stocks, every volume group showed typical advances in cost inventories ranging from 50% to nearly 70%. These remarkable increases reflected the rebuilding of inventory assortments, the acquirement of stocks of goods which had been off the market during the war years, and, of course, a substantial advance in wholesale price levels.

2. Notwithstanding the great rise in sales volume in 1946, the accumulation of inventory was sufficiently great in the latter part of the year to depress the typical stock-turn rate slightly below the peak figures reached in 1945. Nevertheless the figure of 5.25 times (monthly basis) was second only to the figure of 5.4 times in 1945 as the highest annual rate of stock-turn recorded during the history of this study.

3. As has often been observed in the past, monthly stock-turn rates were uniformly higher for large stores than for small stores, turns of five or more times annually being typical above the $10,000,000 mark compared with turns of three to four times annually below the $1,000,000 mark.

EXPENSES

1. The common figure for total expense on an over-all average basis rose fractionally to 28.1% in 1946, only ¼ of 1% of sales above the figure of 27.85% for the preceding year.[1] The total increase in the expense rate since the low point in 1944, however, still amounts to only 0.7% of sales. Expense ratios for all three years, 1944, 1945, and 1946, were lower than any recorded in this study since the early 1920's.

2. The advance in the total payroll percentage from 15.4% to 15.9% of sales more than accounted for the difference in the total expense rate between the two years.

The principal category of expense to exhibit a percentage decrease was real estate costs, with a drop to 2.15% of sales in 1946 from a figure of 2.5% in 1945, an obvious consequence of the augmented sales volume. The advertising expense percentage remained practically unchanged, 2.25% as against 2.2%, and the sum total of all the other natural divisions likewise was virtually identical for both years, 7.8% against 7.75%.

3. Because of the great expansion in dollar sales volume, the expense figures in percentages of sales are quite inadequate to convey a true picture of the situation in 1946. Actually, total dollars of expense for 326 identical firms increased 26.0% in 1946. In payroll, for these same firms, the increase in dollar outlay was 28.8%. Real estate costs, which declined percentagewise, rose in dollars by 8.2% for the 326 identical firms.

4. Increases in several minor elements of expense, while moderate in terms of percentages of sales, were substantial dollarwise and bear watching. The 326 firms . . . experienced dollar increases in their expenditures for supplies and service purchased of 36.5% and 43.8%, respectively, over 1945 costs. A similar advance of 34.1% in imputed interest charges was evidence of the higher investment in accounts receivable and, more especially, in merchandise.

5. An even better measure of total expense than the percentage of sales is afforded by the dollar expense per sales transaction, which, for department stores with sales over $4,000,000 rose to 96 cents per transaction from the figure of 81.5 cents for 1945.

6. As usual, small stores had lower expense rates than large stores. The lowest common total expense figure reported for any group was 20.5% of sales for the $150,000 to $300,000 classification, whereas the highest figure was 28.8% shown by the two groups between $10,000,000 and $45,000,000. Broadly speaking, there were three fairly well-defined general groupings: stores with sales under $300,000, having expense rates of 20% or 21%; stores with sales running from $300,000 to $1,000,000, having expense rates ranging approximately from 23% to 25% of sales; and stores with sales above $1,000,000, having expense rates ranging from 26% to nearly 29%.

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[1] As noted in Table 1 . . . expense figures have been revised for the years 1935 through 1945 for proper comparability with the 1946 results in order to reflect the change in the rate of imputed interest.

7. For the largest stores, executive compensation amounted to distinctly less than 1% of net sales, as contrasted with figures of 4% to 6% of sales for stores with volume under $300,000. Naturally the relationship of the dollar figures was precisely the reverse of the percentage figures: where a single executive in a very small store might draw $3,500 or $4,000 a year, in stores with sales above $20,000,000 a group of five or more top executives might each receive average salaries close to $50,000. The conclusion is obvious that the public pays a low price for high-grade managerial ability in large retail establishments of the department store type.

EARNINGS AND FEDERAL TAXES

1. Net profit (in the narrow sense of the pure merchandise operating profit over and above a total expense figure including an imputed interest charge) diminished sharply in 1946 to the extent of almost 2% of sales, falling to 7.8% of net sales as compared with the 1945 figure of 9.75%. In dollars, net operating profit actually declined slightly from the 1945 level, a remarkable result in the face of the 25% increase in sales. The drop, however, was only 1.1% for the 326 identical firms. . . .

2. Since net other income (including imputed interest credited) remained of the same magnitude as in 1945, the net gain before Federal taxes on income (i.e., the ordinary business profit before taxes) also diminished by nearly 2% of sales, going from 11.5% in 1945 to 9.6% in 1946. The 1946 figure represents a total drop in profit before taxes of 2.7% of sales from the peak profit figure of 12.3% attained in 1944. Nevertheless, because of the 25% increase in dollar sales secured by the reporting stores in 1946, the actual dollars of net profit before taxes were 4.4% greater than in the preceding year. . . .

3. The major factor, however, responsible for the record-breaking final earnings of department stores in 1946 was the greatly lowered incidence of Federal taxes, which required only about 38% of profit before taxes as compared with approximately 69% in 1945, the reason being, of course, the disappearance of the excess profits tax. Thus the final net gain for department stores after taxes in 1946 was 5.9% of sales, as compared with the figure of 3.6% which was typical in both 1944 and 1945. Because of the greater sales volume, as well as the increased percentage of final net gain, 1946 department store earnings dollarwise were approximately twice as high as in 1945, and approximately four and a half times as high as in 1939.

4. The higher department store earnings in 1946 were spread quite uniformly over all the volume classifications, in some contrast to 1945, when small stores achieved the largest percentage earnings after taxes. With respect to the net gain before taxes, the highest percentage figure, 11.6%, appeared for the $750,000 to $1,000,000 sales group, whereas the lowest figure, 9.1%, appeared for the $10,000,000 to $20,000,000 sales group. Thus the range of variation was narrow.

5. Net gain before taxes in terms of cents per transaction was slightly lower in 1946 than in 1945, 33 cents per gross sales transaction as against 35.5 cents.

Federal taxes per transaction, however, were only 12.5 cents in 1946 as against 24.5 cents in the preceding year. Hence the final net gain per transaction was 20.5 cents in 1946 in comparison with 11 cents in 1945, 10 cents in 1944, and 6.5 cents in 1939. (All these transaction figures are for large department stores only.)

OTHER CONCLUSIONS

1. The total per capita sales output, that is, the dollar net sales divided by the average total number of employees, was higher in 1946 than in 1945. This rise was primarily the consequence of higher average prices, since there was some evidence that the average number of sales transactions per total employee was lower in 1946 than in 1945, possibly in consequence of the number of shifts to the 5-day, 40-hour employee-week.

2. There was an increase in the dollar sales per square foot of total space in 1946 over the preceding year. Among larger stores there was also evidence of a slight rise in the number of transactions per square foot of total space. Apparently both physical volume and dollar volume outran any provisions which the reporting stores were able to make for augmented space.

3. Although the total proportion of credit sales to cash sales advanced notably in 1946, reversing the trend of the wartime years, there was no evidence of higher percentage payroll costs in the accounts receivable and credit division. Losses from bad debts, on the other hand, constituted a slightly higher percentage of net credit sales than in the preceding year. There was no indication, however, of any decrease in the turnover of accounts receivable: if anything, the ratio of accounts receivable to net credit sales was very slightly lower in 1946 than in 1945.

4. For the stores with sales over $4,000,000, the lowest expense rates and the highest earnings were characteristically found in the smaller cities. The large store in the not-so-large city still remains the best general formula for success in department store operation.

EXPENSES AND PROFITS OF LIMITED PRICE VARIETY STORES IN 1946: CHAINS AND INDEPENDENTS

VARIETY CHAINS

1. The nationwide retail sales boom brought about an average increase of nearly 16% in total variety chain volume from 1945 to 1946 and a somewhat greater rise in sales per store. The jump in sales per store, typically 17%, exceeded any average year-to-year increase recorded since 1924. The volume expansion differed among merchandise lines broadly classified. At one end of the scale dollar sales of electrical appliances rose about 90%, while at the other end sales of stationery averaged only 1% higher in 1946 than in 1945.

CHART I

LIMITED PRICE VARIETY CHAIN EXPENSES AND PROFITS, 1946

(With 1945 percentages for comparison)

Items	1946		1945 *
	Aggregate Dollar Figures (in thousands) for 40 Chains Operating 5,311 Stores	1946 (Net Sales = 100%)	1945 (Net Sales = 100%)
The chief source of revenue for these chains, of course, was			
Net sales	$1,626,354	100.00%	100.00%
A primary charge against this revenue, and the largest single expenditure, was represented by			
Net cost of merchandise sold	1,029,599	63.31	63.05
Which included the cost of merchandise purchased for resale delivered at the stores, less trade and cash discounts, plus or minus the amounts taken from, or added to, inventories during the year			
Other costs which had to be met were those for operating the chains as follows:			
Salaries and wages	256,021	15.74	15.19
Comprising salaries, wages, and bonuses of all employees including executives, but excluding pensions and payroll taxes			
Tenancy costs	89,382	5.50	6.19
Including rentals, taxes, and insurance paid on leased real estate; taxes, insurance, depreciation, repairs, and interest on owned real estate; and heat			
Light, water, and power	10,171	0.62	0.70
Depreciation of fixtures and equipment	7,430	0.46	0.54
Supplies	11,245	0.69	0.70
Taxes	11,028	0.68	0.82
Not including taxes on real estate, or on income, but comprising other taxes imposed by national, state, and local governments			
All other expense (including interest)	47,105	2.89	2.98
The charge for interest included interest paid on borrowed capital and, in addition, an imputed charge for interest at an average rate of 3.2% on net worth except real estate, leaseholds, and goodwill. Interest on the real estate equity (figured at the same average rate) and mortgage interest were included in Tenancy Costs. Interest received was credited to the Interest account.			
Thus, for merchandise and chain operation combined, these firms experienced a			
Total cost of	1,461,981	89.89	90.17
After meeting these costs, there remained a			
Net profit of	164,373	10.11	9.83
Which constituted the net profit from merchandising operations			

CHART 1 (*Continued*)

LIMITED PRICE VARIETY CHAIN EXPENSES AND PROFITS, 1946

(With 1945 percentages for comparison)

Items	1946		1945 *
	Aggregate Dollar Figures (in thousands) for 40 Chains Operating 5,311 Stores	1946 (Net Sales = 100%)	1945 (Net Sales = 100%)
The chains, however, received			
Sundry or other revenue, net	$ 28,658	1.76%	1.67%
Including any profit or loss on real estate operations; the amount charged in expense for interest on net worth; dividends from manufacturing or foreign subsidiaries; and other miscellaneous revenue			
And, therefore,			
Total net business profit amounted to	193,031	11.87	11.50
This was the earnings of these firms before income taxes			
State and Federal taxes on income amounted to †	....	4.61	7.39
Thus leaving available for dividends, withdrawals, and surplus †	....	7.23	4.08

* Data for 1945 are based on aggregate dollar figures for 39 chains with net sales of $1,400,839,960 and operating 5,325 stores.

† Usable income tax data were available for 31 chains in 1946 and 30 chains in 1945. The total sales of these chains represented approximately 99% of the volume reported in each year by all reporting firms. Since the averages for taxes on income and excess profits and net gain after such taxes are based on a smaller number of reports and slightly lower dollar sales than the other data in the chart, the figures will not necessarily add exactly to net gain before taxes. The tax figure shown for 1945 includes excess profits taxes (net).

2. Total dollar expense per store was the highest in the 17 years for which the study has been conducted. For 15 chains providing complete records over the history of this study, expense per store was one and three-quarters times as high as the average for the period 1935–1939 in comparison with dollar sales per store, which were almost twice as high. Between 1945 and 1946 dollar expense per store rose nearly 14%, while sales per store climbed 17%. Because of the uneven rise in sales and expense, total expense as a percentage of sales declined to the lowest level on record, 26.6% of net sales, both for the 15 selected chains and for all 40 reporting firms.

3. The extent of change in dollar expenses differed markedly among the several component operating accounts. Salaries and wages climbed 20% in dollars in 1946, while tenancy and related costs rose only about 3%. Since these latter semifixed costs constituted about one-quarter of the total expense in 1946, their stability modified the influence on total expense of the substantial rise in payroll.

4. The gross margin percentage for the 15 chains declined from 1945 to 1946 by 0.5% of net sales. The level for all reporting chains, 36.69%, was somewhat below the typical figure of 36.95% for the 39 chains submitting data for 1945. Since total expense averaged 26.58%, the net operating profit for all reporting firms amounted to 10.11% of sales in 1946. Net gain, after the addition of sundry revenue and interest credits, averaged 11.87% of sales. Income tax levies required 4.61% of sales, leaving over 7% of sales, or almost 20% of the average net worth, as final earnings. The 21 corporations indicating dividend payments distributed typically between 2.5% and 3% of sales to stockholders, leaving 4% of sales as contribution to surplus.

5. An analysis used for the first time in this bulletin revealed that inward freight, express, and truckage costs varied markedly with the location of the stores served. These costs were lowest in the North East and highest in the South West and on the Pacific Coast. The averages for the geographical groups ranged from 1.7% of landed costs, or 1.25% of net sales, to more than 4% of landed costs, or over 3% of net sales.

6. Information on methods of compensating store managers reported by 19 chains disclosed that 17 paid their managers salaries plus commissions or bonuses based on store earnings after allocation of overhead expense to the stores. Typical dollar payments were, of course, lowest in small stores and highest in large stores, mounting progressively with each successive size-of-store group. The average amounts varied from less than $3,000 for stores with sales of $30,000 to $75,000 to more than $27,000 for stores with sales of $2,000,000 or more. Percentagewise, however, the average payments were progressively lower from size group to size group, varying from about 5% for the smallest stores to less than 1% for the largest.

Independent Variety Stores [1]

1. Sixty-two independent variety stores submitting profit and loss statements for 1946 reported dollar sales slightly more than 16% above their 1945 volume. With typical sales per store somewhat in excess of $60,000 per year, these firms attained gross margins of 31% to 32% of sales, incurred expense of 25% to 25.5% of sales, and earned net operating profits of between 6% and 7% of sales. Total earnings before taxes averaged nearly 8% of sales, or roughly 30% on net worth. Since 95% of the firms were proprietorships or partnerships, no data on income taxes could be prepared.

2. Salaries and wages, including charges for services of proprietors and partners, averaged about 14% or 15% of net sales, with between one-third and one-fourth of this total going to executives. By and large, payroll costs made up about 60% of the total expense.

3. High percentage earnings were associated with favorable sales increases and with all-around economical operation, while low earnings resulted when percentage costs were unusually high.

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[1] The average figures for reporting independent variety stores may not be representative of all such stores in the country. The evidence suggests instead that the figures indicate the experience of the more competently managed stores.

4. Stores with sales of less than $50,000 in 1946 typically had an average inventory investment of $7,300 and net worth of $10,900. Firms with sales of $50,000 to $80,000 had inventory averaging $11,700 and net worth of $17,200. For stores with sales of $80,000 to $250,000, the corresponding figures were $20,600 and $28,300.

5. Owners' salaries plus net gain before taxes amounted in 1946 to $5,000, $8,000, and $13,700, respectively, for stores with sales of less than $50,000, $50,000 to $80,000, and $80,000 to $250,000.

6. For 31 firms reporting for both 1945 and 1946, dollar gross margin climbed 13% between the two years, while dollar expense rose 14%. Since sales per store mounted more rapidly to a level 18% above the 1945 mark, gross margin and total expense declined percentagewise, the former from 33.13% to 31.79% of sales and the latter from 25.62% to 24.85% of sales. As a result of the greater drop in gross margin the net operating profit percentage decreased from 7.51% in 1945 to 6.94% in 1946.

Table

Operating Results for 15 Identic

(Percentages computed from the aggregate dollar fig

Items	1929	1931	1932	1933	1934	1935	1936
Number of stores	1,579	2,085	2,185	2,188	2,217	2,261	2,303
Net sales (in millions):							
Aggregate	$359	$362	$326	$336	$378	$396	$435
Average per chain	$ 24	$ 24	$ 22	$ 22 *	$ 25 *	$ 26	$ 29
Index of change (1935–1939 = 100):							
Number of stores per chain	67.6	89.3	93.6	93.7	95.0	96.8	98.6
Net sales per chain	82.8	83.3	75.0	77.4	87.0	91.2	100.2
Average sales per store	122.5	93.4	80.2	82.7	91.7	94.2	101.6
Gross margin	32.7%	32.2%	31.5%	35.6%	35.0%	34.4%	35.0%
Salaries and wages	13.0%	13.1%	13.0%	13.9%	14.3%	14.2%	14.1%
Tenancy costs	8.8	11.2	13.0	10.0	9.0	8.6	8.2
Light, water, and power				1.1	1.0	1.0	1.0
Depreciation of fixtures and equipment				1.1	0.9	0.8	0.8
Supplies	1.6	1.5	1.3	1.3	1.3	1.4	1.3
Advertising	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Insurance (except on real estate)	0.4	0.3	0.4	0.4	0.4	0.4	0.4
Taxes (except on real estate or income)	0.3	0.4	0.4	0.7	0.9	0.7	0.8
Miscellaneous expense	1.1	1.0	1.1	0.9	0.8	0.8	1.1
Total expense before interest	25.4%	27.7%	29.5%	29.7%	28.9%	28.2%	28.0%
Total interest	1.4	1.3	1.3	1.3	1.1	1.0	0.9
Total expense including interest	26.8%	29.0%	30.8%	31.0%	30.0%	29.2%	28.9%
Net profit	5.9%	3.2%	0.7%	4.6%	5.0%	5.2%	6.1%
Net other income	2.7	2.4	2.7	2.3	2.0	2.0	1.9
Net gain before income taxes:							
Percentage of net sales	8.6%	5.6%	3.4%	6.9%	7.0%	7.2%	8.0 %
Percentage of net worth	20.1 †	10.7	5.7	11.6	12.5 †	12.8 †	15.0 †
Income taxes ‡	.....	.....	.....	.....	.....	.....	.....
Net gain after income taxes ‡	.....	.....	.....	.....	.....	.....	.....
Stock-turn (times a year) based on beginning and ending inventories	5.2	5.3	5.1	4.9	5.0	5.0	5.1

* The statement of one firm did not cover a full fiscal year. The average is adjusted to reflect sales for the entire period.

† Because of inadequate balance sheet data in the case of one chain, the figure for net gain as a percentage of net worth was not based on the reports of all the chains in the group.

‡ This item consists of state and Federal taxes on income and includes for the years, 1940–1945, wartime excess profits taxes net of postwar refunds, debt retirement credits, or the equivalent. Figures are based on data for 13 firms having 99.5% of the total sales volume of the 15 chains in each of the years, 1939–1946.

4

AL VARIETY CHAINS: 1929, 1931–1946

ures; combined net sales = 100%, except where noted)

1937	1938	1939	1940	1941	1942	1943	1944	1945	1946
2,341	2,374	2,395	2,405	2,420	2,430	2,418	2,403	2,388	2,371
$450	$433	$456	$483	$555	$647	$690	$729	$750	$869
$ 30	$ 29	$ 30	$ 32	$ 37	$ 43	$ 46	$ 49	$ 50	$ 58
100.3	101.7	102.6	103.0	103.7	104.1	103.6	102.9	102.3	101.6
103.8	99.7	105.1	111.3	127.9	149.2	159.0	168.0	172.8	200.2
103.5	98.1	102.5	108.0	123.5	143.4	153.6	163.3	169.0	197.2
35.1%	34.6%	35.2%	35.2%	36.7%	37.2%	36.9%	37.6%	37.5%	37.0%
14.7%	14.9%	14.7%	14.7%	14.8%	15.0%	15.3%	15.0%	15.4%	15.8%
8.2	8.9	8.7	8.3	7.5	6.6	6.1	5.8	5.8	5.2
1.0	1.1	1.1	1.1	0.9	0.8	0.7	0.7	0.7	0.6
0.8	0.9	0.8	0.8	0.7	0.6	0.6	0.6	0.5	0.4
1.4	1.1	1.0	1.0	1.1	1.0	0.9	0.8	0.8	0.8
0.4	0.4	0.4	0.5	0.4	0.4	0.3	0.3	0.4	0.4
0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3
1.0	1.2	1.2	1.1	1.1	1.0	1.0	0.8	0.7	0.6
1.1	1.2	1.3	1.3	1.4	1.5	1.5	1.7	1.9	1.7
29.0%	30.1%	29.6%	29.2%	28.2%	27.2%	26.7%	26.0%	26.5%	25.8%
1.0	1.0	1.0	1.0	1.0	0.9	0.9	0.8	0.9	0.8
30.0%	31.1%	30.6%	30.2%	29.2%	28.1%	27.6%	26.8%	27.4%	26.6%
5.1%	3.5%	4.6%	5.0%	7.5%	9.1%	9.3%	10.8%	10.1%	10.4%
2.1	2.1	2.2	2.1	1.9	1.5	1.5	1.5	1.5	1.4
7.2%	5.6%	6.8%	7.1%	9.4%	10.6%	10.8%	12.3%	11.6%	11.8%
13.9 †	10.1	12.1	13.0	19.0	24.2	25.1	30.5	27.9	30.9
.....	.....	1.3%	1.9%	4.5%	6.8%	7.0%	8.7%	8.0%	4.6%
.....	.....	5.5%	5.2%	4.9%	3.8%	3.8%	3.6%	3.6%	7.2%
4.9	4.9	5.1	4.8	4.3	4.2	4.4	5.0	5.3	4.8

Note: The charges for interest on real estate used in the business and interest on net worth (exclusive of real estate, leaseholds, and goodwill) were revised for the years, 1931–1944, to reflect the change in interest rates adopted for the 1945 study. Consequently the figures shown above for those years for the items, tenancy costs, total expense before interest, total interest, total expense including interest, net profit, and net other income, differ from the corresponding data published in Bulletin No. 123, *Expenses and Profits of Limited Price Variety Stores in 1944*, and earlier bulletins. An explanation of the procedure followed is presented in Bulletin No. 125, *Expenses and Profits of Limited Price Variety Stores in 1945*.

TABLE 24

OPERATING RESULTS FOR 62 FIRMS OPERATING INDEPENDENT VARIETY STORES, 1946

(Net sales = 100%, except where noted)

Items	Aggregate Figures	Median ‡ and Range Figures		
	Percentages Computed from the Combined Dollar Figures of the 62 Firms	Percentages Computed from the Figures for Each Firm Taken Individually		
		Median ‡ Figures	One-Half the Reported Figures, Centered on the Median, Lay within the Limits Listed Below	
Aggregate number of stores	66			
Aggregate net sales	$4,859,839	100.00%		
Average sales per store	$ 73,634	$60,030	$45,053	$91,137
Change in sales (1946/1945)	....	116.63	109.95	126.22
Net cost of merchandise sold (including freight, express, postage, and truckage)	68.68%	67.90%	65.91%	70.02%
Gross margin	31.32	32.10	29.98	34.09
Salaries and wages:				
Executive	4.23%	4.57%	3.17%	6.26%
Other	10.74	9.84	7.46	12.03
Total salaries and wages (subtotal)	(14.97)	13.84	12.44	17.50
Tenancy costs (including heat)	2.81	2.70	2.07	3.87
Light, water, and power	0.60	0.56	0.44	0.74
Depreciation of fixtures and equipment	0.45	0.49	0.29	0.74
Supplies	0.72	0.77	0.50	1.02
Advertising	0.56	0.42	0.22	0.76
Insurance (except on real estate)	0.51	0.39	0.26	0.63
Taxes (except on real estate or income):				
Sales	0.66	0.00	0.00	0.00
Other		0.62	0.43	0.82
Franchises or membership fees in voluntary chain organizations	0.41	0.39	0.06	0.85
Miscellaneous expense	1.64	1.36	0.98	1.82
Total expense before interest	23.33%	23.40	19.50	26.70
Total interest §	1.75	1.77	1.46	2.15
Total expense including interest	25.08%	25.44	21.10	29.09
Net profit	6.24%	6.72	3.22	9.66
Net other income (including interest on net worth)	1.66	1.62	1.32	1.99
Net gain before income taxes:				
Percentage of net sales	7.90%	7.97	5.04	11.55
Percentage of net worth ‖	30.42	29.32	19.98	38.70
Rate of stock-turn (times a year) based on beginning and ending inventories	3.82	3.48	2.82	4.46
Discounts and allowances received	*	0.85 †	0.68 †	1.07 †
Freight, express, postage, and truckage	*	1.29 †	1.19 †	2.01 †
Population of city ¶	.....	3,238	1,870	6,495
Distribution of stores among cities with populations of ¶				
Less than 10,000	50			
10,000–25,000	2			
25,000–100,000	3			
100,000–500,000	5			
500,000–1,000,000	1			
1,000,000 or more	1			

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* Data not available.

† Usable figures for this item were given on less than 75% of the reports.

‡ All the medians were set independently; therefore the sum of the individual items does not necessarily equal the total.

§ Total interest includes any interest paid on borrowed capital plus an imputed charge for interest at 6% of net worth other than real estate. The latter interest is credited back under Net Other Income so that the final net gain is not affected by the inclusion of such interest as expense.

‖ The figures for this item were based on data for 56 firms.

¶ In the case of reports covering two stores, only the location of the principal one was indicated.

V. MARKETING OF AGRICULTURAL PRODUCTS AND RAW MATERIALS

HOW GOODS MOVE FROM THE FARM

BY CLARE W. BARKER AND MELVIN ANSHEN

"The farmer fills the American market basket."
"The farmer can't fill his own market basket."
"The farmer is the foundation of our economy."
"The farmer is a poor businessman."
"The farmer is victimized by the marketing process."
"Everyone tells the farmer what to do—and then he doesn't do it."
"The farmer is all right—what he needs is to be left alone."

CHARACTERISTICS OF FARMING AND FARM PRODUCTS [1]

This is a picture of farming: 6 million scattered farms worked by owners or tenants; the quality and quantity of their crops at the mercy of wind, rain, sun, cold, heat, and insects; production scattered and products perishable, far from major markets, needing standardizing, grading, financing, and transportation; fixed costs high and prices swinging wildly caught between stable demand and volatile supply. This is the foundation of the nation's market basket. This is where America goes to dinner. To some it is a way of life; to others a one-crop specialized industry. Always it is an industry bursting the bonds of scientific control, defying management, belying forecast and plan. This is the other end of the marketing cycle: poles away from the consumer who sees the product of our farms as food or, even more remotely, as the raw materials of his finished products. This is where the physical process of marketing begins.

Longer than any other unit of production the farm has remained economically independent. It is a production unit with increasing costs feeding an inelastic demand.[2] Against this difficult background the farmer, separated often by thousands of miles from the great consuming centers, sells his product at prices

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Source: *Modern Marketing* (New York, McGraw-Hill, 1939), pp. 36–51. Reprinted by permission.

[1] D. W. Malott, *Problems in Agricultural Marketing* (New York, McGraw-Hill, 1938), pp. 1–6. The introduction gives a good picture of the varied problems faced by those marketing agricultural products.

[2] Owing to the inelastic demand, a small increase in the volume of production may cause a marked decline in price.

over which he has no control. Both quality and quantity of what he raises are at the mercy of the weather, atmospheric conditions, and insect pests.[1] When he plants he does not know what price will prevail at harvesttime. He cannot forecast his income. He cannot predetermine his sales volume. He cannot budget his costs, nor will they yield to low selling prices so as to guarantee him a profit.[2] If the price at harvesttime is low, seldom can the farmer withhold his crop from the market. Governed by the perishability of what he raises, he must offer his supply at the ruling price and accept what he can get. Usually there are a number of different channels through which he may market his product.[3] It takes a keen business judgment to weigh the advantages and disadvantages of each.

The farms are scattered and their products nonuniform. The marketing process beginning at the farms resembles the picture of many streams flowing into a large central reservoir (the central market) and then dividing again into many streams flowing toward the consumer. Before farm products can be distributed to consumers, they must be concentrated in the central reservoirs of the major wholesale markets.

In part that concentration process is necessitated by savings in transportation costs made possible by carlot shipments.[4] In part it is brought about by the need for grading and standardizing farm products,[5] processes which can be carried on more effectively in central markets than on the individual farms. In part it is due to the superior financing facilities of large, organized central wholesale markets where buyers and sellers can assemble and minimize the risks of price fluctuations.

The marketing process which begins on the farm is also affected by the seasonal nature of agricultural production.[6] There is no constant flow of farm products to market; at certain periods of the year there is a superfluity of supply and at other periods a dearth. Great strains are placed on marketing agents and agencies in handling the erratic flow of farm products. The producing areas are limited, and attempts to increase or reduce production may not be effective for a period of from several months to several years. Efforts by the farmer to control his production in accordance with prevailing prices may be fruitless, since, by the time the change in quantity produced becomes effective, the price situation which encouraged that change has altered.

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[1] This is in marked contrast to the manufacturing industries.

[2] Many of the farmer's costs are fixed costs (taxes, insurance, etc.) and stay the same whether he has a large crop or a small one.

[3] Malott, *op. cit.* Cases beginning on pp. 17 and 41 show the problem presented by alternative marketing channels.

[4] Since most farm products are very bulky in relation to their value, the cost of transportation is very high. Thus, out of the price paid by the consumer, a large proportion is due to the cost of transportation.

[5] Machines can produce standardized products, but nature does not. Even the cattle from one farm and the apples from the same orchard will have varying qualities. Yet the packer desires to purchase cattle of the same grade, and the consumer wants his box of apples to be of the same size, color, and shape. Thus there is always the problem of grading agricultural products.

[6] The seasonal production of farm products and their fairly even consumption throughout the year makes the storage function an important one. The bulkiness of these farm products makes these costs also high as a percentage of the price to the consumer.

Increasingly in the past generation farming has become a specialized industry. One-crop farming is a common practice. Failure of that crop or the presence of an unsatisfactory price may make the entire season one of loss rather than profit.

CONCENTRATION ON FARM PRODUCTS

The typical farm is located at a great distance from the major consuming centers.[1] Beef cattle are raised, on the average, 650 miles from their consumption points, hogs 250 miles, and sheep more than 600 miles. California fruits and vegetables are marketed in New York City. Pacific apples are sold on the Atlantic seaboard. Cotton raised in Gulf States is sold throughout the country. Crops can be raised only on farm lands wherever they may exist and where climatic conditions are favorable; industrial enterprises, within certain limits, may locate anywhere. The tendency for industrial enterprises to concentrate in certain parts of the country, because of favorable transportation facilities, access to raw materials and markets, and the presence of the necessary labor supply, has contributed to the complexity of the task of marketing farm products.

So it is that farm products proceed to the consumer by way of large central wholesale markets where the crops of small individual farms are concentrated and where a number of other activities are carried on. The typical farm is too small to permit economical processing of farm products. It is also too small for the farmer to attempt to sell his products directly in the central market. The individual farmer with his small crop lacks necessary market contacts. He needs immediate cash payment. He does not have the time to supervise selling in the major markets. His crop is too small to interest large-scale buyers. Transportation rates are another factor helping to strengthen the need for concentrating farm products. Rates on carlot shipments are relatively lower than rates for less than carlot shipments. To secure these savings in transportation rates, it is usually necessary to concentrate farm products at local shipping points so that carload lots may be moved to central wholesale markets.

In yet another way is the farmer handicapped by his distance from the major consuming centers. Removed by hundreds of miles from the large city markets, without either information about, or familiarity with, central market procedure, he is compelled to turn the task of marketing his produce over to others—specialists in this function. In most cases the activities and interests of farmers stop with the sale of their products to local buyers.[2] This is the first phase of the concentration process which has been compared to the confluence of many streams into a large central reservoir. It is a process largely carried on by specialized agents, rather than by the individual farmer.

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[1] This accounts for the farmer's interest in transportation, since he must rely on an efficient transportation system to get his products to market. He wants the facilities of this system to be available to him when he needs them and at a reasonable cost.

[2] Cooperative marketing provides an exception to this statement, since this form of marketing carries the farmer's interest beyond his own neighborhood out into the central markets.

Classes of Markets

In the process of marketing farm products a number of concentration points are utilized. These have different names, and to prevent confusion, it is important to distinguish between them.

It is possible to divide all the concentration points or markets into four broad classifications:

1. *The local market*[1] to which produce is hauled from farms. This point may be only a shipping point or may serve as an actual market with purchase and sale activities.
2. *The central market*[2] where shipments from local markets are concentrated.[3] Here the process of concentration reaches its height, and the process of dispersion begins.
3. *The secondary wholesale market* where distribution to retailers occurs.
4. *The retail market* where produce is sold to consumers.

The local market may be offered as a general descriptive term applied to the first country concentration point. Here the producer exchanges his merchandise for ready cash. Standardizing and grading may begin. Storage may occur. More important, transportation is available for bulk freight movements from the local market to the central wholesale market.

The central market[4] is the major reservoir or concentration point for farm products. Here standardization and grading are completed. Goods may be stored. Contact is effected between the agents and agencies connected with the concentration phase and those connected with the dispersion phase of the marketing of the farm products. Here are located the major risk-bearing and financing functionaries. The process of dispersion, the breakup of shipments of produce begin here. There is some indication of a lessening in importance of these central markets.[5] In livestock marketing, for instance, we find the packer often going out to the producer to buy rather than waiting for the producer to ship his livestock to the central markets.[6]

The secondary wholesale market is one step nearer to the ultimate consumers of merchandise, and often represents the end of bulk freight movement. Breakup of shipments occurs here. Retailers purchase here from wholesalers for distribution to consumers.

The retail market is the retail store. Further breakup of merchandise shipments takes place for consumer distribution. Again there is transfer of ownership. This is the end of the distributive process.

Not all products follow the same pattern from farm to consumer, and in the case of different trades a variety of names may be applied to the markets.

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[1] This is sometimes described as a country market.

[2] This is sometimes spoken of as a primary or terminal market.

[3] E. A. Duddy and D. A. Revzan, "The Changing Relative Importance of the Central Livestock Market," *The Journal of Business*, July, 1938. Chapter I tells how the central market is organized and how it operates.

[4] Malott, *op. cit.*, pp. 160–165, gives a short description of a central wholesale market, the Chicago Livestock Market.

[5] Duddy and Revzan, *op. cit.*, Part 2.

[6] Malott, *op. cit.*, pp. 182–195. This case gives a good description of "direct marketing" of livestock. (This term refers to the buying of livestock at other than central markets.)

Speaking generally, however, it is possible to visualize these four broad classifications of markets utilized in the distribution process for almost all types of farm products. A single city may serve as more than one type of market. Chicago furnishes an example of a city which serves as all four types of markets. Local truck farmers may bring produce directly to the city. It is a central market for livestock. It is a secondary market for practically all manufactured and agricultural products. And in common with any town or city it is a retail market. A city may be a central wholesale market for certain products, may be a secondary market for other products, and will, of course, have many retail markets. Transportation and financing facilities, storage space, and nearness to producing and consuming markets, all are elements necessary for a central market. Secondary wholesale markets need these elements to a lesser extent because of the smaller volume of merchandise handled.

SALE TO LOCAL MIDDLEMEN

A great many farmers engage in direct selling of their products. This may be to the ultimate consumer by means of roadside markets, huckstering, the retail public market, or selling by mail. It may also be to industrial consumers such as canning plants. However, the great bulk of farm products are marketed through middlemen. A number of different local middlemen operate in the farm areas. They purchase from individual farmers and sell to agents in the central wholesale markets. They initiate the concentration process and relieve the farmers of responsibility and risk for the marketing of their produce.

One well-developed method of sale in this classification is by individual farmers to local buyers. Local buyers, for example, purchase livestock from small producers and assemble them into carlots for shipment to the central markets. Country elevators buy wheat from farmers and sell in turn to elevators in the central markets. In addition to purchasing wheat, the local elevator operators may perform many other services, such as inspection, grading, weighing, storage, cleaning, conditioning, and mixing.

These local buyers are really country merchants whose major function is to relieve the farmer of the difficulty of supervising and guiding the marketing of his small portion of the total crop. The country general store in many cases takes the farmer's produce in trade. Tobacco warehouses, potato warehouses, cream and milk stations are other examples of local buyers.

Another well-defined method of sale is to the traveling buyer. In certain sections of the country traveling buyers have established regular routes for purchasing eggs, poultry, butter, and similar products for resale in the major wholesale markets. In many instances the traveling buyers represent large city wholesalers or large chain-store companies or processors. They travel through the farming territory, following the cycle of the various crops. Occasionally they contract in advance of the harvest to purchase the entire crop of the farm. Like the local or resident buyers, the traveling buyers relieve farmers of all risks except those connected with production.

Still another well-defined method of sale is through the producers' co-operative selling associations. An outstanding example of this method of sale is found in the milk industry. In 1935 there were almost 9,000 cooperative selling associations with 2,500,000 members. The total value of products handled by these associations during 1934–1935 amounted to over $1,300,000,000.[1]

It should be noted that these cooperative selling associations do not abolish any marketing functions or activities. Whatever is done by the local or traveling buyer or the central wholesaler must also be done by the cooperative selling association which attempts to replace them. They strengthen the position of the individual farmer so that he may obtain a higher price for his crop, and they may retain for the individual farmer the profits normally earned by the independent middlemen. To do this, however, they must perform the marketing activities as efficiently as they are performed by independent middlemen. Unless they can do this, they sacrifice a large part of their potential benefits.

SALE TO RETAIL STORES

Still another well-developed method of sale is direct to retail stores. In some localities retail butchers purchase livestock direct from farmers. Chain-store companies often buy fruits and vegetables from individual farmers and ship them to their stores. On the whole, however, only a small portion of all farm products is marketed in this manner. The reasons why this method of sale has not been utilized to a greater extent are (1) the supply is not dependable as to either quantity or quality, since the individual farmer usually is not equipped to grade his own produce; (2) it is too expensive for the individual farmer to provide the daily shipments demanded by retailers; (3) the individual farmer is in no position to extend credit to retail stores; (4) the retailer cannot depend upon one farmer to supply all his needs and so must maintain relations with a number of producers; and (5) the individual farmer often cannot provide a sufficient quantity of the particular quality demanded. Of all these difficulties perhaps the major one is the failure of adequate grading to be performed under this method of sale.

SALES TO MIDDLEMEN IN OUTSIDE MARKETS

Some large producers of fruits and vegetables sell direct to purchasers in central markets. A producer of cotton may sell his crop in one of the central markets through a cotton factor[2] or commission house.[3] A livestock producer may consign shipments to commission men in the central market.[1] This method of sale may also be used for other crops. The commission method of marketing is frequently resorted to when the shipments from individual farms are too small and irregular to attract local buyers, when the crop is not standardized, when the crop is perishable and there are no local buyers available, and when the market at the destination point is highly organized.

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[1] Ward W. Fetrow, *Cooperative Marketing of Agricultural Products* (Farm Credit Administration, Cooperative Division, Washington, D.C., U.S. Government Printing Office, 1936).

[2] "A type of commission merchant who usually advances funds to the consignor. His work consists: (1) in financing the operations of the shipper who may be a grower but who is usually a country buyer or merchant; (2) in warehousing or storing the goods; (3) in grading; (4) in selling the goods." ("Definitions of Marketing Terms, Consolidated Report of the Committee on Definitions," National Association of Teachers of Marketing and Advertising.)

[3] "An agent (functional) middleman transacting business in his own name who exercises direct physical control over the goods consigned to him and negotiates their sale. He usually enjoys broader powers as to prices, methods, and terms of sale than does the broker although he must obey instructions issued by his principal. He generally arranges delivery, extends necessary credit, and collects." (*Ibid.*)

In recent years the practice of selling through commission agents of various types has declined in favor of sale direct to wholesalers often through their traveling buyers. The marketing process for many farm products was so hazardous formerly that few buyers were willing to incur the risk involved in outright purchase without paying such low prices that farmers were unwilling to sell to them. In recent years, with production more specialized and on a larger scale, crops have been standardized to a greater extent and shipped to market in graded carlots. Increasing distances between producing areas and consuming markets have made the grower less inclined to entrust to distant commission men the sale of their products. Closer relations have been established between producers and central-market wholesalers so that outright sale is becoming more popular.

In the central markets buyers and sellers are brought together. Ample storage space and facilities for handling agricultural products are available. Financing and market news services are offered. Good transportation from producing areas and toward consuming areas is necessary for the movement of the actual product. A city which hopes to be a central market must have a constant body of buyers and sellers, it must provide physical provisions for handling the goods, and must facilitate the exchange of title.[2]

AUCTIONS FOR FARM PRODUCTS

Certain farm products,[3] notably fresh fruits and vegetables [4] and tobacco,[5] are commonly sold at auction in the central wholesale markets. This method of sale provides a quick way of disposing of farm products for cash. The auction houses store products and often grade and catalogue them, but their major function is to provide facilities for the rapid transfer of products from producer to wholesale purchasers. At an auction the shipper is represented by a salaried or commission agent. Produce arrives daily, is catalogued, and displayed for inspection by buyers. Sales are made from catalogue numbers with the auction company charging a relatively small proportion of the sale price as a fee for its services. When sufficient volume is offered to maintain a constant flow of business, sale by auction is an inexpensive method of marketing perishable products. It may not be so attractive from the buyers' point of view, however, because of the time consumed by individual buyers waiting to purchase lots of produce in which they are interested.

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[1] Duddy and Revzan, *op. cit.*, pp. 10–13.

[2] Chicago offers an example of a central market with these facilities.

[3] In recent years there has been some development of markets for the auctioning of livestock at country points in the Middle West.

[4] J. W. Park, *American Fruit and Vegetable Auctions*, U.S. Department of Agriculture Circular 250 (Washington, D.C., U.S. Government Printing Office, 1932).

K. B. Gardner, *Terminal Fruit Auctions*, Farm Credit Administration Bulletin 29 (Washington, D.C., U.S. Government Printing Office, 1938).

Malott, *op. cit.*, pp. 76–83.

[5] Malott, *op. cit.*, pp. 62–65.

H. B. Rowe, *Tobacco under the AAA* (Washington, D.C., The Brookings Institution, 1935), Chap. II.

The main abuses of the auction sale are misrepresentation by the auctioneer, private sale in advance of the public auction, withdrawal of certain lots of produce in unfavorable price situations, and the combination of buyers. These abuses are being eliminated under the precautionary procedure of the modern auction company.

There is a difference of opinion as to whether auctions make for stable or fluctuating prices; what they do offer at all times is quick disposal of perishable products. The method of sale may result in the securing of a low price for produce of poor quality. It may also result in nonstandardized prices, since purchase may be in small lots. In the prevention of market gluts caused by incapacity of buyers to assume title to sudden arrivals of merchandise, the auctions may be said to limit extreme fluctuations of prices.

COMMISSION DEALING IN FARM PRODUCTS

The commission dealer in farm products is distinguished by one characteristic: he does not take title to the merchandise he handles, but rather he acts solely as an agent for his principal. The commission agent or the commission house may perform many services in connection with the marketing of farm products. He helps to finance the sale of farm products; he buys and sells future contracts; he supplies market information; he insures fair treatment for the client; and he assists in supervising transportation arrangements. He usually has excellent market connections, and his selling costs are low. At the conclusion of the sale the commission agent collects the proceeds, deducts the necessary expenses, including his own profit, and credits the balance to his principal's account. Goods are usually sold on a consignment basis when shipments are small and are offered at such infrequent intervals as to be unattractive to local buyers, when goods cannot be standardized or graded locally, and when the market at the destination point is large, well organized, and supported by many buyers.

The practice of selling through commission agents has been decreasing and that of direct sale to wholesale purchasers has been increasing in recent years. From time to time there has been some suspicion of malpractice by commission men, but in general the reasons leading to the change have centered around improvements in the whole marketing procedure, including swifter and more efficient transportation and better organized central wholesale markets. In addition, the growth of the practice of grading at local shipping points has enabled country shippers to secure the confidence of large wholesale buyers. Commission houses still have a place in handling the sale of the many farm products which remain unstandardized or which are sold irregularly in very small amounts.

FUTURE TRADING IN FARM PRODUCTS

One of the most difficult and fascinating problems in agricultural marketing is the study of price movements. The relation between price and profit for the farmer is perhaps more direct than in most other industries which have relatively flexible costs. . . . At this point we shall attempt merely to describe briefly the part which price plays in marketing farm products. The description will not be complete, but it may suggest some of the problems which are involved and some of the effects upon the farmer.

What factors influence the formation of prices of farm products? As is usually the case, a complexity of forces are at work. Part of the influence is future trading in farm products. . . .

Future trading in farm products is made possible by the existence of organized markets where standardized goods may be purchased and sold. Trading in futures is not carried on in actual merchandise but in the purchase and sale of contracts calling for delivery at future dates. The future price of wheat today is the price today for contracts calling for the delivery of wheat at a specified future date. The future price, therefore, is usually higher than the cash price (the price for actual wheat delivered today) by the cost of storing that quantity of wheat for the period between today and the delivery date specified in the future contract, plus interest and finance costs, and plus other incidental charges which may be incurred in storing wheat.

This divergence between cash and future price may be called the "normal spread." The actual spread between cash and future prices may be greater or less than the normal spread. Such movements away from the normal relation between the two prices occur as a result of special supply and demand conditions. A large supply of wheat in storage in Chicago elevators may depress the cash price, while drought conditions existing at the same time may forecast a limited harvest and thus a smaller future supply. This latter outlook will operate to force up the future price of wheat. The spread between cash and future price widens. A dearth of cash wheat and the prospect of an abundant harvest will raise the cash price and depress the future price, with a consequent narrowing of the spread.

To carry on trading in future contracts, there must be available standard grades of nonperishable merchandise which will always be offered in sufficient quantities to fulfill contracts. There must also be a volume large enough to support continuous trading so that at any price buyers and sellers will always be available. The rules for trading in futures are established by the commodity exchange on which the trading proceeds. These rules usually cover such points as the definition of contract grades of the products to be traded in, the requirement of adequate margins, relations between the individual firms engaged in trading, requirements for delivery of merchandise on contract, and the liquidation of damages on default. Future trading, therefore, is limited to those farm crops which can be readily graded. The important grains and cotton are among those commonly traded in on organized exchanges.

Since the cash price of a product and the future price are closely interrelated, usually varying by the cost of storage during the intervening period, the two prices generally move together. Under special conditions the spread between cash and future price may vary from the normal spread which is equal to the cost of storage. Just as the future price influences the cash price, so does the future price influence the price paid to the farmer. In the case of wheat, for example, the cash price today for wheat is usually less than the future price by the cost of storing the given quantity of wheat for the given time period. Hence the price paid to a wheatgrower in Dakota is less than the cash price for wheat on the same day on the Chicago Board of Trade by the cost of transporting wheat from the local elevator to Chicago, plus the cost of storing wheat at the local elevator (including insurance, interest, etc.), and plus the profit of the local elevator. Thus there is a direct relation between the price today of future contracts for wheat on the Chicago Board of Trade and the price paid to the farmer by his local elevator operator. That relation is a complex one, however, inasmuch as the future price represents the aggregate of estimates of future production and the effect of future production on present production and supplies in storage. Future price influences cash price, and cash price influences future price.

COST OF MARKETING FARM PRODUCTS

Other factors besides future trading influence the prices of farm products. One influence, of course, is the cost of marketing farm products. It has been estimated that more than 50 per cent of the price the consumer pays for bread goes to cover the cost of marketing that bread; 55 per cent of the price of meats and dairy products is needed to cover marketing costs; and 60 per cent of the retail price, it has been estimated, is required to cover the cost of marketing oranges. The costs of marketing various products are not similar, but whatever the cost may be, it exerts a direct influence on the retail price. The retail price of a product should be composed of three parts: (1) the cost of the product, (2) the cost of marketing the product, (3) the hoped-for profit.

A number of factors are included in the phrase "cost of marketing." One of them is the perishability of the product, including the amount of waste and spoilage which occurs between the farm and the ultimate consumer. This makes it necessary for merchants to secure prices high enough to compensate for the losses suffered as a result of waste. Another factor is the irregularity of supply, which contributes to marketing costs through the necessity of storing merchandise. A third factor is the volume of merchandise offered; fluctuations in volume make storage necessary and bring about unbalanced supply-demand relationships. A fourth factor is the extent to which the commodity lends itself to grading; price schedules for ungraded merchandise are irregular and losses may be suffered as a result of buyers' unwillingness to pay for unreliable goods. Still another factor is the relation between the bulk of the product and its value; a product with large bulk and low value will assume a heavy burden of transportation costs. One more factor is the packaging required before the product can be sold to the ultimate consumer. So we see that a product which is grown at a great distance from a consuming market, which is perishable and requires swift transportation, and which has a relatively large bulk may have very high marketing costs. If this product also requires packaging, the cost will be increased. On the other hand, a product which is grown near its major consuming market, which is relatively nonperishable, and which does not require elaborate grading facilities or packaging may have very low marketing costs. For the first product the consumer may find as much as 50 per cent of the retail price going to cover marketing costs. For the latter product perhaps only 5 per cent of the retail price will be required to cover the cost of marketing.

INFLUENCE OF DEMAND AND SUPPLY ON PRICE

Demand and supply conditions also influence the price of farm products. The demand for farm products used as food is relatively inelastic. We consume about the same total quantity of food in good times and bad, at high prices and at low. The demand for different products may vary according to the price, but the total demand for farm products does not vary. In a major depression consumers with curtailed incomes will purchase cheaper cuts of meat and will substitute other low-cost foods for meat in their diets. They still, however, consume about the same total quantity of farm products.[1]

The demand for some farm products has been experiencing a long-continued increase. This has been true, for example, of fruits and vegetables for a period of over 25 years. The demand for other farm products, such as wheat and the more expensive cuts of meat, has been following a long curve of decrease. Changes of this type are the result of basic shifts in the national diet and reflect the switch from meat and bread to fruits and vegetables.[2]

Contrasting with the relatively stable demand which exists for most farm products used as foods, the supply of farm products is anything but constant. Production varies from year to year, governed by conditions beyond the control of the farmers. Most of the changes in supply are caused by the weather. There is no quick and accurate adjustment of the supply of farm products in response to price movements. If the price is high, the normal expectation would be that the farmers would increase the acreage planted and so increase the supply and eventually bring about a reduction in price. Any attempt by a farmer to follow this procedure may be met, however, by abnormal weather conditions which would destroy his entire crop. In other cases increased supply brought about by a rise in prices may not reach the market for several years. This is particularly true of the orchard crops. A farmer who increases his supply in response to a high price existing this year may find that, by the time he is ready to market his increased crop, the price has fallen. The same conditions inhibit action undertaken in response to a low or a falling price level.

Still another factor often influences the price situation: with relatively fixed costs, the farmer is constantly attempting to maximize his income. If prices fall due to an excess of supply over demand, rather than decrease his supply the farmer is likely to plant more in the effort to maintain his income at the same level. He is induced to do this because his costs will not be materially reduced if he should plant less. The result, of course, is that, as the price falls due to the excess of supply over demand, more and more is planted and the supply, rather than being reduced, becomes greater. At the same time, under conditions of inelastic demand, there is not much increase in the amount consumed even at the reduced price.

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[1] For a detailed study of consumer buying habits in a depression period see A. R. Tebbutt, *The Behavior of Consumption in Business Depressions* (Harvard Business School, Bureau of Business Research, Business Research Studies No. 3, 1933).

[2] Advertising campaigns of such organizations as the California Fruit Growers' Exchange have played a part in this shift in the diet of consumers. Health movements and diet fads have played their parts, too.

Normal supply and demand relations, therefore, exist in the marketing of farm products only in a rather limited field. It is generally true that over a long period supply and demand conditions find their equilibrium in price. During short periods, however, the relation between supply and demand and price may frequently be abnormal. To determine the price situation existing for any crop at any time, a very careful analysis of supply and demand conditions is required. Often the potential future supply is of greater importance in its effect upon price than the actual supply, and so the effect of the price of future contracts exerts an important influence upon the cash price of farm products, which may also be determined in part by the cost of marketing those products and by the conditions of supply and demand existing for those products.

DECENTRALIZATION IN AGRICULTURAL MARKETING—CAUSES AND CONSEQUENCES

BY GEOFFREY SHEPHERD

Readers of this *Journal* are well aware that the agricultural marketing system has been passing through a revolution during the past 20 years. It is rapidly becoming decentralized. Prior to 1920, the major part of the stream of farm products flowed through the large central markets at Chicago, Kansas City, Minneapolis, etc., on its way from the producer to the consumer. Today a major share of most farm products flows through a decentralized marketing system that shortcuts the central markets entirely.

In the old central market system (actually it was a local-market-and-central-market system) the goods passed through several hands on their way from producer to consumer. Farm products were first assembled by horse and wagon at innumerable small local markets out in the country, made up into carload lots and sent either by the farmer or by the local dealer to the large central markets. The newer decentralized market system cuts out some of those steps. It is based upon a sort of intermediate market, intermediate in size and number

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Source: *The Journal of Marketing*, Vol. VI, No. 4, Part 1 (April, 1942), pp. 341–348. Reprinted by permission.

between the local markets and the central markets. In these markets the goods pass directly from the hands of the farmer (or of his local dealer) into the hands of the processor or retailer.

The shorter route from the producer to the consumer is not necessarily better than the longer route. But powerful forces must have been at work to bring about this revolutionary change from centralized to decentralized marketing. The consequences have been widespread, and not all to the good. The process of price determination has become decentralized as well as the movement of the physical goods, and the collection and dissemination of market news about prices, receipts, shipments, etc., has become more complex and difficult. The purpose of this article is briefly to show the extent of the decentralization of agricultural marketing, to reveal the causes of the change, and to outline the chief problems that it has created. The article will then conclude with suggestions for dealing with some of the problems.

EXTENT OF CHANGE

The best data to show the extent of the decentralization of agricultural marketing in quantitative terms are the livestock marketing statistics compiled by the Agricultural Marketing Service. They show the percentages of livestock sold through the decentralized marketing system by months since 1923.

The percentages differ for the different kinds of livestock, but they are all alike in one respect: The percentages sold "direct" have all more than doubled since 1923. More than half the hogs in the United States are now sold direct, through the decentralized marketing system. In Iowa, the percentage is about 70. These shipments move from the producer to the consumer without going through the large central markets.

Statistics on other commodities are scarce, but dealers say that the same sort of change has been taking place in the marketing of other farm products. In grain, in cotton, in fruits and vegetables, in butter, the story is the same.

CAUSES

The local and central market system reflected the transportation and communication facilities existing at the time. During the nineteenth century, two different classes of transportation were available—the horse-drawn wagon, adapted to small lots but limited to distances of a few miles, and the railroad and steamship, adapted to large lots and long distances. The market system also reflected two different classes of market information—word of mouth at local markets, and the telegraph associated with central markets. Finally, because of the lack of commodity standardization goods had to be purchased on the basis of inspection, which meant that the determination of price and transfer of title had to be performed in the presence of the goods, or at least in the market where the goods were. The physical goods had to follow the same geographical route as the economic processes of price determination and transfer of title.

The revolutionary change from the centralized market to the decentralized market that took place after World War I similarly reflected basic technological changes in transportation and communication. In transportation, the introduction of the high-speed truck and the rapid extension of concrete highways were major events. These changes reduced the cost and improved the speed and reliability of the short-haul movement of goods to market. Goods could be assembled and dispersed in large enough volume for efficient processing at the markets in small towns or cities out in the country as cheaply, rapidly, and continuously as at the great terminal or central markets in metropolitan centers. From the physical point of view, the marketing job could be done as well at small cities in the country such as Austin or Waterloo as at Chicago or Kansas City.

The truck and the paved highway made decentralization of the handling of the product physically possible. By a fortunate coincidence, a second invention came along at the same time and made that decentralization *economically* coherent. This second invention was the radio. In its field, communication, it was a perfect parallel to the other invention in its field, transportation; for the radio is the perfect instrument for disseminating market news to the decentralized market. The truck and the concrete highway scatter "the market" over the whole producing area; the radio similarly scatters the market news over the whole area right into the producers' homes. The one complements the other.

The radio would not have been of much use if there had been no market news to broadcast. The federal government, well aware of the market decentralization that was taking place and alive to the potentialities of the radio, vastly expanded its news-reporting service in the 1920's, and still more in the 1930's using all three agencies—the press, the telegraph and telephone, and the radio. It did its best to decentralize its market news step by step with the decentralization of physical marketing. It also made great strides in commodity standardization. There is not much use reporting prices if there is no common language in which the different grades of the commodities concerned can be described.

The advent of the truck and the paved highway after 1920 introduced a transportation agency that filled the gap between the short-haul wagon and the long-haul railroad. The radio similarly filled the gap between the localized word-of-mouth means of communication and the long-distance telegraph or telephone. Standardization, spreading to more commodities, reduced the need for concentrating goods merely for inspection. The breakdown of the previous clear separation between local and central markets, and the rise of a new intermediate type of market, was a natural resultant of these changes. Not only did the physical goods short-cut the central markets to a greater and greater extent; the market news and the process of price determination short-cut them too. The new intermediate markets, instead of being articulated vertically, as it were, with the central markets (both in the flow of goods and the determination of prices) are articulated horizontally with each other. Prices in these "direct" markets are as likely to lead those in the central markets now as to follow them. The "concentration, equalization, and dispersion" of the physical goods that used to take place at the central markets is now spread all over the country, and the price-determining and title-transferring process is spread along with it. The *market place* or *market point* has given way to the modern *decentralized market* covering the country as a whole.

CONSEQUENCES

The consequences of the rise of decentralized marketing are varied. Most of them appear to be beneficial, but some of them may not be so good.

It is fairly well agreed that decentralized marketing reduces costs. It costs about 20 cents per 100 pounds to put hogs through the stockyards at the central markets. In the case of corn, the commission charge at the terminal market is one cent per bushel; for wheat, it is a cent and a half. Most of these costs as such are avoided when farm products are sold direct; some other costs may be incurred instead, but if so they are usually smaller than these central market charges. From an over-all point of view, the social cost of the congestion at the central markets is difficult to measure, but it must be considerable.

The chief controversies about decentralized marketing do not center on costs, but on the effects on prices. These price problems may be illustrated by specific commodities.

BUTTER PRICE QUOTATIONS

Decentralized marketing appeared early in the butter trade—some time before World War I. The prices quoted at the central markets not only represented sales at those markets, but in addition were used as a "trading basis" or "settling basis" for the butter sold "direct," off the central markets.

This use of the central market price quotations as a settling basis for "direct" sales simplified the price-determining process considerably for the direct sellers. It enabled creamery managers to contract with wholesalers to take their butter week in and week out at, say, one-half cent over the Chicago quotation, whatever it might be. The wholesalers could make similar contracts with jobbers, and they, in turn, could contract with retailers. This saved them all the trouble of having to make separate bargains each day or week.

These direct sales do not show up in the central market receipts and price quotations. But they are made on the basis of the prices established at the central market—at so much over or under the central market quotation. It becomes imperative, therefore, that this central market quotation accurately reflect the prices at which the bulk of the commodity is being sold on the central market (or would be sold if the commodity were not moving direct from seller to buyer).

Several methods have been used to insure accuracy in price quotations. One is the "call-board" method, by which dealers come together on the trading floor at a specified time and make bids to buy and offers to sell. If a large proportion of sales were made at the prices bid and offered, as on the grain exchanges, the "call" would represent actual prices accurately. But it is precisely because a large proportion of the trading is not thus made public that the call system is instituted, to bring some indicator of prices to light. Where the volume of business transacted at the "call" is very small, however, the method is unsatisfactory.

In some cases, the quotation committee method has been used. These quotation committees are usually composed of dealers who are in touch with market conditions and might, therefore, be expected to quote prices which accurately reflect those conditions. But, as a matter of fact, the quotation committee method is susceptible to abuse; the traders who constitute the committee are apt to be influenced by their own positions as buyers and sellers. The Elgin Board, for example, was for some time dominated by producers of butter, and their influence was exerted upward on the price quotation; at another time, an influx of Chicago traders had an opposite effect. In this and other cases, the committee price quotation was finally attacked in court as fraudulent information, and enjoined.[1]

Thus, even before World War I, the central market system for butter, eggs, and poultry was beginning to feel the effects of competition of a different system—sales made direct between seller and buyer, or decentralized marketing. After 1920 the movement was accelerated. Co-operative creameries developed large-scale overhead selling organizations such as Land-O'Lakes, Challenge, and the Iowa State Brand Creameries, and these reached forward to the retailer without going through the central markets. From the other end of the marketing system, the chain stores reached backward to the individual creameries and to their selling organizations, also going around the central markets. Mergers and consolidations of private butter producers and dealers also took place. The bulk of the butter today is marketed direct. Wholesalers and jobbers have combined, and thereby taken one link out of the distribution chain, but even so they handled only 36 per cent of butter sales in 1935. In that year about 55 per cent moved direct from the creamery to the retailer or large-scale user, and the marketing of the remaining 9 per cent was integrated all the way to the ultimate household consumer.[2]

During recent years the amount of butter traded in the central or terminal markets has declined so greatly that the question is now being raised whether the volume is great enough to warrant quoting their prices at all.[3] The bulk of even the wholesaler-jobber's business is handled on the premium-over-the-market-quotation basis. "Direct purchasers have offered premiums to divert the butter from the central markets, and the central market receivers have had to meet the premiums in an effort to retard the shift. . . . Today virtually all butter is sold to receivers on the basis of an agreement. The receiver agrees to pay a price based on a specified wholesale quotation as reported at a specified time for a specified market" [1]—a quotation which has not been established at the time the agreement is made.

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[1] F. E. Clark and L. D. H. Weld, *Marketing Agricultural Products* (New York, Macmillan, 1932), pp. 339–341.

[2] William H. Nicholls, *Post War Developments in the Marketing of Butter* (Iowa Agricultural Experimental Station, Research Bulletin No. 250, 1939), p. 370.

[3] L. M. Davis, "Fewer Open Market Butter Sales," *The Agricultural Situation* (U.S. Department of Agriculture, July, 1937), pp. 19–20.

The prices at which a very small amount of butter is sold on the open market therefore become the basis for the prices of all the rest of the butter. A very small tail appears to wag a very large dog. The question is now being raised, therefore, whether the prices of this small amount of butter are representative and accurate enough to serve as a basis for settlement for all the rest of the butter—whether some means should be found to make the price quotations more representative, or whether they should be discontinued altogether and some more adequate basis for butter price settlement devised.

It is not a sufficient answer to say that the thing will take care of itself—that if the quotation is too low, competition for supplies will force the market price up; or if it is too high, butter will pile up in storage. There are too many monopoly elements in the butter distribution system. The price quotation might lower prices to producers without lowering prices correspondingly to consumers.

No simple answer to these questions has been offered. Paul Quintus believes that the practices described above have not affected the level of wholesale butter prices. His general conclusions are:

"The widespread existence of premiums can mean only that the wholesale quotations understate the true value of the bulk of the wholesale transactions. There is an increasing sentiment among traders and others that the industry would benefit from the use of a quotation which more nearly represented the value of each grade of butter. This is simply another way of saying that the premium system probably is not to the best interests of the trade.

"It is equally clear that the premium system inherently has certain pernicious effects from the standpoint of the seller. There are so many direct and indirect ways of introducing a premium into the sale that more or less confusion prevails among creameries as to their best outlet. There is ample evidence that creamery managers attach considerable significance to the apparent amount of the premium and may actually go so far as to place more importance upon it than on the actual net returns for the butter."

Livestock Prices

Some central livestock market interests have claimed that decentralized marketing removes part of the demand from the central markets, thereby weakening prices there, and thus lowering prices all over the country.

Perhaps all that is necessary to meet this argument is to offset it against the opposite argument that used to be made by some butter interests. They used to claim that selling butter direct reduced the supply of butter offered for sale at the central butter markets and thereby *raised* prices there and all over the country. Both arguments are clearly fallacious. It seems obvious that the supply and the demand are equally reduced in both cases, and the effect on prices is nil.

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[1] Paul E. Quintus, "Wholesale Butter Prices and Premiums," *Journal of Farm Economics*, Vol. XXI, No. 1, Part 1, pp. 595, 600.

There is no reason to believe that decentralized marketing lowers prices at the central markets. But even if a reduction in the demand at the central markets did lower prices there, the transfer of that part of the demand to the decentralized markets out in the country would raise prices out there, not lower them. The simplest and most direct kind of statistical evidence—the direct comparison of prices at interior points and central markets—has abundantly proved that livestock prices in the interior do not remain in any fixed relation to prices at the central markets from day to day, month to month, or year to year. They would not decline merely because prices at the central markets declined, unless there was a general decrease in demand or increase in supply for the United States as a whole. Both for this reason and because the livestock price quotations at the central markets accurately reflect the prices there, the central market price-quotation problem that exists in the butter trade is not a problem in the livestock trade.

Some other livestock price problems of a more subtle kind have attracted less public attention than the bugaboo about the effect of decentralization on the price level, but they have more substance. The decentralized livestock market is plagued by the problem of price quotations, not at the central markets but at the decentralized markets out in the country.

The federal government has done its best to provide good decentralized market quotations in areas where a large share of the livestock is marketed direct. The problem of providing accurate, detailed, and comprehensive decentralized market quotations, however, is inherently difficult. The price surface over the area is uneven, and prices differ at different points. If the reporter merely quotes the range of prices over the area, no one can tell just where the price peaks and valleys in the area are. The same thing is true, only on a smaller scale, when prices are quoted by sections within the area. There is an obvious need for quoting prices by individual market points in the area, but two things make this difficult. One is the tradition that the government will not quote prices by specifically named individual buyers. Another is that the number of market points is rather large, and broadcasting numerous individual quotations would take a lot of radio time. A few packers located out in the country now broadcast their own price quotations individually, but if very many did that, it would be difficult for a farmer to catch them all. Furthermore, there is no ready means for checking on the accuracy of the quotations put out by the packers themselves.

On top of all this comes another difficulty—that individual lots of livestock differ greatly in value. This means that (1) either the quotation at each point is made in the form of a pretty wide range (since the grade of livestock cannot be objectively determined, like grain, under present arrangements) so that the quotations are only a rough guide to prices for particular lots; or (2) the quotations are made narrow to avoid this difficulty, and that means that too nearly a flat price is paid for good, bad, and indifferent livestock. This penalizes the producer of high-grade stock and overpays the producer of poor stock. It is probable that this particular problem will remain unsolved, perhaps unsolvable, until the basis of the sale of livestock is shifted from the live animal to the carcass. But that is a whole story in itself.

SOME POSSIBILITIES

It may be that the open competitive system will not be able to do a satisfactory job of price determination in our decentralized agricultural markets. The problem may be solved, however, from another direction—as a minor incident in the general broad sweep of various government price control programs in agriculture.

One example of this is the Danish hog price committee which for several years before World War II used to meet once a week and set the price for hog carcasses at slaughtering plants for the coming week. This committee would set the price that they believed would clear the market. Denmark is a small country, and their hog carcasses were highly uniform in grade and weight, so they did not have much trouble with geographical price differentials, nor with grade-price differentials, as we would in the United States.

A clear example of price determination by group decision in this country is the way milk prices are determined in the various milksheds. A more important example is the ever-normal granary programs, under which the loan values pretty well set the price in the open market. Another example is the purchases by the federal government under the lend-lease act.

Most of these control programs were set up primarily to stabilize prices over periods of time. They are already, however, having important effects upon the stability of price relationships over areas of space, as well as over periods of time. They are also having effects in some cases on price relationships in form—between different weights, grades, etc., of farm products. The original, ever-normal granary cotton loans ignored differences in the location of the market points and in the grade and staple of the product. Now they include differentials for both. Both kinds of differentials have been in effect with wheat from the first. The corn loans have been made on the basis of a flat (geographical) loan rate, although differentials may be introduced beginning with the 1941-42 crop year.

Some of the problems involved in decentralized marketing therefore, that now appear like a Gordian knot, may be cut, rather than untied, by developments in the broad field of commodity price stabilization. The solutions already made have been only incidental to major engagements on a broader front, and in some cases they may have been rather rough and ready solutions. But the elements of new and radical solutions to old and new problems are in the making, and some of the problems that appear insoluble today may be dissolved, rather than solved, in the near future.

SOME NOTES ON FORECASTING THE PRICE OF A COMMODITY

BY JOSEPH L. SNIDER

American industry is faced constantly with the risk of a substantial change in the prices of its materials and its products. In a list of 40 of the most important commodities in American industry [1] there were 15 which fell in price by more than 50% from 1929 to 1932. Not one of the selected commodities showed a net gain during the period, and only six declined by less than 20%.[2] These drastic changes were, of course, a part of the severe business depression of those years. But the prices of individual commodities have changed considerably even in periods of comparative stability of the general price level. Thus, during the period 1922–1929 the maximum increase from one year to the next of the "All Commodities" index of the Bureau of Labor Statistics was 5.4%, and the maximum decrease between consecutive years was 3.5%. In the list of 40 commodities, however, all but 8 (rayon, worsted goods, pig iron, silver, bituminous coal, brick, cement, and paper) showed more than a 10% in-

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Source: Prepared by Joseph L. Snider for Malcolm P. McNair and Richard S. Meriam, *Problems in Business Economics* (New York, McGraw-Hill, 1941), pp. 241–253.

[1] The selected commodities were as follows:

- Farm products and foods
  - Butter
  - Cattle
  - Coffee
  - Corn *
  - Cotton *
  - Eggs
  - Flour
  - Hogs *
  - Lard *
  - Sugar
  - Wheat *
- Textiles
  - Cotton gray goods *
  - Rayon
  - Silk *
  - Worsted goods
- Metals
  - Copper *
  - Lead *
  - Pig iron
  - Silver
  - Steel †
  - Steel scrap *
  - Tin *
  - Zinc *
- Fuels
  - Coal, anthracite †
  - Coal, bituminous †
  - Coke †
  - Fuel oil
  - Gasoline *
  - Petroleum, crude
- Building materials
  - Brick
  - Cement †
  - Glass
  - Linseed oil
  - Lumber
  - Structural steel †
- Miscellaneous
  - Hides *
  - Leather
  - Paper
  - Rubber *
  - Wood pulp

* Declined in price by more than 50% from 1929 to 1932.
† Declined in price by less than 20% from 1929 to 1932.

[2] The *monthly average* price for each year was used in the comparisons. The percentage changes were, of course, greater between the highest and the lowest *single months*.

crease between consecutive years at some time during the period; and all but 7 (cattle, butter, steel, anthracite, brick, cement, and paper) showed more than a 10% decrease.

The price risk can be shifted by industry to other risk-takers only in limited measure. Satisfactory hedging against price changes is feasible for comparatively few of the important products of industry.[1] Therefore, buyers, sellers, and all others financially interested in commodity markets must make price forecasts.[2] Such forecasting involves a large element of uncertainty because of the limited understanding of the influences which bring about price changes and the inadequacy of the measurements of the significant influences.

Nature of the Commodity and Its Market

Basic to successful price forecasting is an understanding of the nature of the commodity and its market. The price of a given commodity will fluctuate quite differently from the price of another by reason of characteristic and fundamental differences in supply or demand conditions. An understanding of supply and demand characteristics involves knowledge on such questions as the following:

1. Is the price set in the domestic or the world market? The answer to this question sets the geographic limits to the measurement of the price-determining factors. The prices of most of the important raw materials are set in the world market. Moreover, the prices of manufactured products, even those which are

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[1] In 1938, facilities for trading in futures on organized exchanges were available for 37 commodities, but even for this number the trading facilities did not in all cases permit a complete hedge. These 37 commodities, as listed by the Commodity Exchange Administration of the U.S. Department of Agriculture, were as follows:

Barley
Butter
Canned goods
Cheese
Cocoa
Coffee
Copper
Corn
Cotton
Cottonseed
Cottonseed meal
Cottonseed oil
Crude oil
Eggs
Flaxseed
Gasoline
Hides
Lard
Lead
Millfeeds
Molasses
Oats
Peanuts
Pepper
Potatoes
Provisions (bellies, ribs)
Rubber
Rye
Silk
Soy beans
Sugar
Tallow
Tin
Tobacco
Wheat
Wool top
Zinc

[2] Although it is manifestly impossible to ascertain the measure of success achieved by private business forecasters, an indication of the accuracy of the published price forecasts of a number of commercial forecasting organizations is available in a study made by the American Telephone and Telegraph Company. (Results published by Seymour L. Andrew and Harold M. Flinn in the *Journal of the American Statistical Association*, March, 1930, *Supplement*.) The study examined the recommendations of each of four commercial services on the purchase of each of 10 commodities by months for the 4-year period 1925–1928 and, allowing for omissions, included over 1,500 separate forecasts. Each recommendation was placed in one of three categories according to whether the purchaser (1) would have saved money by following the advice of the forecaster, (2) would have about broken even, or (3) would have lost money, taking account of the customary policy as to commitments. It was found that 51% of the forecasts fell in the first class, 24% in the second, and 25% in the third.

manufactured and sold domestically, are more largely influenced by world conditions than is often realized, foreign influences being transmitted through the raw material and the money markets.

2. Are there tariffs or other barriers to the free flow of the commodity in international trade; and particularly, does any change in this situation impend? Any important change in trade barriers against a commodity tends to widen or narrow its market and therefore has a stimulating or a depressing influence on its price.

3. Is the commodity a main product or a by-product? This makes a great difference in a price analysis. In the case of a by-product, the price is likely to fluctuate especially widely since the supply of a by-product does not change sensitively to variations in demand for it, but changes according to variations in the output of the main product. Therefore, prospective production of the main product is a decisive consideration in estimating the future supply and price of the by-product. It may also be observed that in making a price forecast of a by-product no attention need ordinarily be given to its cost of production. The great majority of the important commodities of industry are, of course, main products. In the representative list cited on page [378], only hides, lard, and steel scrap are by-products.

4. Do changes in the price of the given commodity depend upon changes in the price of some related commodity? The prices of many manufactured goods are dependent upon the prices of their raw materials, being set on the basis of the cost of replacement. Cotton goods and leather typify this group. A price analysis of such commodities, therefore, resolves itself principally into an analysis of the price prospects for the raw materials in question. There are also many manufactured products of lesser individual importance whose prices change seldom and very little, notwithstanding appreciable changes in the prices of their raw materials. It is usually possible to ascertain with respect to a given manufactured product whether it falls in the first or the second group.

5. Can the supply of the commodity be changed rapidly, slowly, or only periodically? When a change in demand for the commodity takes place, the nature and extent of the price change will be determined very largely by the response of supply. This, in turn, depends upon the conditions of production, the extent of unused productive capacity, and the availability of transportation. The supply of manufactured products and products of the mines can ordinarily be increased rapidly under the stimulus of rising demand.[1] It is possible also to curtail promptly the output of the factories and mines following a decline in demand; but there is a natural hesitancy to do so, which delays readjustment of supply. The supply of agricultural products, as a rule, cannot be adjusted rapidly in response to changes in demand. The prices of these products therefore tend to fluctuate widely.

6. Is supply predictable and controllable? It may be possible for the supply of a commodity to change substantially but for such changes to be neither pre-

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[1] Among the 40 important industrial commodities previously referred to there are 22 whose supply can be increased promptly: cotton goods, worsted goods, copper, lead, pig iron, silver, steel, tin, zinc, anthracite, bituminous coal, coke, fuel oil, gasoline, petroleum, brick, cement, glass, lumber, structural steel, paper, and wood pulp.

dictable nor controllable. Crude petroleum is a case in point, although during the last few years some progress has been made in controlling the supply. Unpredictability of supply increases the element of uncertainty in the price outlook.

7. Is there political or other noneconomic control over the supply or price of the commodity, and especially, is such control likely to be changed? The existence of artificial control constitutes an unstable element in the picture because artificial control devices are constantly subject to breakdown. What appears to have been one of the most effective control schemes, but which nevertheless broke down eventually, was operated by the United States copper producing companies during 1929 and 1930, when the price held at 18 cents for 12 months despite increasingly difficult conditions. When control broke down, the price collapsed. Moreover, merely the prospect of a change in control may have an influence on the price. This was illustrated by the price declines in wheat, cotton, and other commodities under the control of the AAA following the decision of the Supreme Court in May, 1935, declaring the NIRA invalid.

8. What is the competitive situation among the producers of the commodity? If there is a dominant producer who leads the market, his probable price policy may be the preeminent consideration in making a forecast. If there is monopolistic competition among a few strong producers, price changes may be restricted within a comparatively narrow range. If, on the other hand, there is severe price competition with price cutting readily resorted to, price changes will be wider and more uncertain, particularly in a buyers' market.

9. Is there any organization among the buyers? A united front on the part of buyers would tend to restrain a price advance in a sellers' market and to intensify a price decline in a buyers' market. But a degree of unification on the part of buyers sufficient to have an important bearing on the market price is rare. Purchasing associations and large unit buyers are an approximation to the situation. Even here, however, the principal effect of unified buying is probably a lower price to these buying units rather than a change in the open market price.

10. Is there integration in the industry? Where the buyers of a commodity are financially affiliated with the sellers to any important extent, the price fluctuations of the commodity will be less sensitive to changing supply and demand conditions than is usually the case; bargaining in the market will be less intense. If the sellers dominate the affiliation, the price will tend to rise more sharply and fall less sharply than it would if no affiliation existed; whereas if the buyers are dominant, the price will tend to rise less sharply and fall more sharply.

11. Is demand elastic or inelastic? Information on this point helps the analyst in making an estimate of the probable *extent* of the price change resulting from a given change in the supply, or, more precisely, in the supply-demand relationship. Where the demand is elastic, a given change in the supply will bring a less severe change in the price than where the demand is inelastic.[1]

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[1] The U.S. Department of Agriculture has done a considerable quantity of pioneering work on the problem of the statistical relationship between changes in supply and price for a number of agricultural products. References to these studies may be found in "Price Analysis—Selected References on Supply and Demand Curves and Related Subjects," *Agricultural Economics Bibliography*, No. 48, U.S. Department of Agriculture, 1933.

12. Is there a difference in the relative influence of supply and of demand upon price; and if so, which is more important? There are many commodities, agricultural products in particular, whose demand remains fairly constant but whose supply undergoes substantial changes. For such commodities the price forecaster may well devote chief attention to a study of supply. There are also many commodities, principally manufactured products, whose demand changes drastically but whose supply is readily adjusted to changes in demand. For these commodities the principal emphasis in the analysis should be placed upon demand. It is also true that for some commodities the relative importance of supply and of demand changes seasonally. In the case of cotton, for example, the supply factors appear to exert the dominant influence upon the price during the planting, growing, and picking seasons, whereas demand conditions are more important during the other portions of the year.

CHARACTERISTIC PRICE CHANGES AND RELATIONSHIPS

A study of the fluctuations during a period of years of the price of a commodity under analysis will often disclose some characteristic fluctuation which will be useful in current forecasting. There may also be discovered some helpful relationships with other business and economic factors. A discussion of several characteristic fluctuations and relationships follows:

1. Seasonal variation characterizes the price fluctuations of a number of commodities, notably in the groups of agricultural and food products. Seasonal variation in price would ordinarily be expected in those markets having a seasonal change in either the supply or the demand without a corresponding change in the other of these two price-determining factors. Seasonal variation in production, storage on a large scale being uneconomic, with a comparatively constant demand is more often to be found than seasonal variation in demand with a comparatively constant supply. Seasonal variation in the prices of manufactured commodities is not common for the reason that supply can usually be adjusted to changes in demand. In some cases, however, the price of a manufactured product will show a seasonal fluctuation because of a marked seasonal fluctuation in the price of its raw material. It should be noted also that for certain commodities there is a special sort of seasonal price fluctuation, brought about by seasonal changes in the quality of the product rather than by changes in the supply-demand relationship. Hides and potatoes are illustrations in point.[1]

2. Differences in characteristic amplitude of cyclical price fluctuations are exhibited by commodities. Information as to whether a given commodity has usually fluctuated widely or narrowly will, consequently, be of value in forecasting. With a cyclical change in demand, those commodities whose supply cannot be adjusted easily will tend to exhibit a wider price fluctuation than those whose supply can be adjusted easily. As noted at an earlier point, there

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[1] Comments on the seasonal price fluctuations of various commodities specifically may be found in Simon Kuznets, *Seasonal Variations in Industry and Trade* (New York, National Bureau of Economic Research, 1933).

appears to be a contrast between the prices of agricultural commodities and of manufactured products, the former tending to show the wider amplitude. In those markets where there is close control over the supply of the commodity, little or no change in price may follow a substantial change in demand. This does not necessarily imply control over the supply by a monopoly. Competing producers have on occasion curtailed output sharply in response to a fall in demand and thereby have been able to maintain the price.[1]

3. It is sometimes possible to discover a time relationship during a representative period between the fluctuations in the price of the commodity and in some other economic series. For example, by comparing the price fluctuations of individual commodities with the fluctuations of the average price level, it has been discovered that certain commodities are "early movers" at cyclical turning points while others are "late movers." Professor Mills, in his study of the price fluctuations of some 200 commodities in the United States during the period 1890–1925,[2] found that, among others, cattle, hogs, sheep, hides, leather, wool, silk, copper, and lead were early movers; while cotton, print cloths, coal, both anthracite and bituminous, petroleum, and steel rails were late movers. Pig iron and steel billets were late at the cyclical upturns and early at the downturns. Moreover, there are a few economic series outside the field of commodity prices which tend to anticipate commodity prices at turning points. The average price of high-grade bonds and the average price of industrial common stocks are important instances. In forecasting the price of a commodity it is useful, therefore, to ascertain whether it is an early or a late mover during cyclical fluctuations and to give special attention to those economic series which are particularly sensitive to impending developments.

4. A comparison of the current price with the "normal" price for the commodity may often be of value in forecasting. The existence of a normal price implies a tendency for the actual price to move in the direction of the normal whenever there is an appreciable difference between the two. If the actual price should be far above the normal, for example, this fact might be the dominant element in a forecast that the price will decline. But it is always difficult and often impossible to determine the normal price. For some commodities, it is possible to ascertain approximately the marginal unit cost of production. The figure must be approximate because the cost of production is difficult to ascertain and is defined differently under different business circumstances, and also because the marginal supply is impossible to designate precisely. Nevertheless, if used with discretion, an estimate of the normal price on the basis of the marginal cost of production may be helpful.

Another measure of normal price, applying to agricultural products, has been developed by the Department of Agriculture. On the basis of supply-price relationships over a period of years, but also taking into account other factors, the average price to be expected for a crop year may be estimated early in the year, as soon as the supply for the year is rather definitely known. This expected average price taken as a normal may then be used as the basis for interpreting current price levels and forecasting changes in those levels during the year.[1] Where it is not possible to estimate either the marginal cost of production or the average price for a crop year, the average price over a period of years, making allowance for any long-time tendency to rise or fall, may serve as a rough indication of the normal price.

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[1] This situation has been described as an "administered market." For a discussion of the significance of "administered" prices, reference may be made to a report on *Industrial Prices and Their Relative Inflexibility* made by Gardiner C. Means and submitted to the Senate by the Secretary of Agriculture, Jan. 15, 1935.

[2] Frederick C. Mills, *The Behavior of Prices* (New York, National Bureau of Economic Research, 1927), Appendix Table XI.

SUPPLY AND DEMAND ANALYSIS

Knowledge of the commodity and its market, of any characteristic price fluctuations, and of any relationships that may exist between the price movements of this commodity and other economic series is important in price forecasting, but is somewhat in the nature of background. The most important approach in making an actual forecast is the supply and demand analysis.[2]

THE IMPORTANCE OF DATA ON COMMODITY STOCKS

Data on commodity stocks constitute the most important item of information in making a price forecast for certain commodities, namely, those for which the demand is reasonably stable and the supply irregular and not readily adjustable. Unfortunately, there is a marked reticence on the part of business organizations to divulge the facts on inventories. There appears to be a widely held conviction that secrecy in this matter may strengthen the bargaining position, which in itself is a commentary on the forecasting value of stocks data. There are, to be sure, many commodities—those produced only on order and those whose supplies can be adjusted very easily to changes in demand—for which comparatively little attention need be given to inventory data. In forecasting the prices of such commodities, the principal emphasis should be placed upon prospective demand.

SEASONAL VARIATION IN STOCKS

In the use of data on commodity stocks, seasonal variation should be recognized where it exists. For those commodities whose consumption is reasonably steady throughout the year but whose production is on a seasonal basis, seasonal variation in stocks is unavoidable. A great many commodities, primary products of the earth which enter without elaborate fabrication into human consumption, fall in this class. Seasonal variation in stocks may also exist because of seasonal variation in consumption accompanied by steady production throughout the year. Seasonal variation in stocks may or may not bring appreciable seasonal variation in the price of the commodity, depending principally upon the practicability and cost of storing the stocks.[1]

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[1] See, among other statements issued by the Department of Agriculture, *A Description of Price Forecasting* presented at a conference with State representatives, annual outlook meeting of the Bureau of Agricultural Economics, Jan. 26, 1928; and the statement by Mr. Lloyd S. Tenny, Chief of the Bureau of Agricultural Economics, at the hearings before a Senate subcommittee, Seventieth Congress, First Session, pursuant to Senate Resolution 142, A Resolution to Investigate the Recent Decline in Cotton Prices (Washington, D.C., U.S. Government Printing Office, 1928).

[2] This statement would not apply to forecasting by the commodity speculator who tries to catch the short swings. Although the speculator keeps informed on the statistics of supply and demand, he regards such data as too insensitive for his needs. He is inclined to stress "psychological" factors and analyses of the "technical" position.

Normal Stocks

The determination of the significance of commodity stocks at any given time is usually difficult because of the absence of a reliable indication of the size of normal stocks. It is often assumed that a certain number of weeks' or months' supply at the current rate of shipment constitutes a normal supply and, consequently, that the price will tend to rise or fall when actual stocks are below or above the assumed normal. This procedure has a certain rough and ready usefulness, but it contains pitfalls. For the purpose of price forecasting, a given number of weeks' supply does not have the same significance when shipments are at a high rate as when shipments are at a low rate. A six weeks' supply, for example, may be wholesome at a time of average activity but may be dangerous at a time of great activity because of the ever-present probability of a sharp falling off in demand. It is necessary, therefore, to consider the size of inventories with respect to probable changes in demand, as well as with respect to the current rate of activity.

Invisible Stocks

One of the most serious limitations of the data on commodity stocks is their failure to include stocks at all positions. Stocks in the hands of the original producers are customarily included and quite often also stocks in the hands of dealers and handlers, but it is very rarely that stocks in the hands of consumers are added. There is, therefore, very inadequate coverage of the total supply. The invisible stocks, which never get into the figures, may oftentimes be decisive in a price change. Where the consumers are industrial establishments equipped to stock ahead, there may be in existence a considerably larger unused supply of the commodity than the inventory statistics indicate. The copper industry illustrates this limitation. Statistics on stocks of refined copper are not available for any positions beyond the refinery, although the refinery sells to the so-called fabricators, who in turn sell to industrial consumers, such as public utilities, automobile plants, and electrical manufacturing companies. Both the fabricators and the industrial consumers have apparently stocked copper heavily at certain times when advances in price were expected. Such was the case during 1928 and the first part of 1929. Although the stocks in the hands of fabricators and consumers were of great importance in estimating the probable movement of the price, the statistics did not reveal the facts. It was possible in that situation to reach a rough estimate of the size of the invisible stocks by comparing the shipments of refined copper with the rate of activity in the important consuming industries during preceding months.

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[1] There may be found in Kuznets, *op. cit.*, monthly seasonal index numbers of stocks for a large number of commodities important in the industries of the United States.

Even where more than the producers' stocks are included, stocks at the different points are ordinarily not published separately. The advantage of separation may be exaggerated since the most important information is the size of total stocks available for use; but where there are differences in the financial strength of producers, dealers, and consumers it has some bearing on the price estimate to know whether the stocks are held at points of financial strength or weakness.

PROSPECTIVE SUPPLY AND DEMAND

It is too often forgotten in price forecasting that, in addition to the measurement of supply and demand conditions prevailing at the time the forecast is made, the supply and demand conditions during the period covered by the forecast must be estimated. If a six months' forecast, for example, is being attempted, the probable conditions of supply and demand during the ensuing six months must be estimated carefully. The following lines of attack will ordinarily be of assistance in making estimates of prospective supply.

1. A comparison of the current volume of production of the commodity with the industry's total possible production should be made in order to discover the facts as to excess productive capacity. A large excess of capacity creates a persistent tendency toward overproduction and acts as a restraint upon a rise in price following an increase in demand. The financial condition of the producers and the competitive situation among them will largely determine the extent to which the excess capacity will be employed. A strong financial condition and a far-sighted competitive attitude may counteract the natural tendency toward overproduction. Then, too, transportation conditions may at times make it impossible to bring to market the volume of output which might actually be turned out. There is also the question of actual or probable governmental control over production in view of excess capacity.

2. The existing cost-price relationship may throw light on prospective supply. Speaking very generally, there is a tendency for individual producers of a commodity to curtail or suspend their operations when the price of the commodity has fallen below their respective variable costs of production. Total new supply comes to market, therefore, in reduced volume. On the other hand, when the price has again risen above the variable costs of the higher-cost producers, these producers once more enter the market and add to the total supply. Special stimulation is of course given to production when the cost-price relationship is such as to afford an attractive profit. These tendencies are modified in practice by many factors. Costs are often not known accurately; and numerous internal situations and external competitive conditions also help to determine the scale of operations in individual establishments.

3. For most of the agricultural commodities, estimates of prospective supply are made public by the crop-reporting service of the Department of Agriculture. The market prices of these commodities respond sensitively to the crop reports and to some extent discount them in advance. The Outlook Reports, also issued by the Department of Agriculture, supplement the statistical estimates of prospective supply.

An estimate of prospective demand may be arrived at by examining the need for the commodity, the purchasing power of the buyers, and their willingness to buy:

1. It is very difficult to measure the need for a commodity, but a presumption as to its size may be set up by comparing the actual consumption of it during the recent past with the average or normal volume of consumption. Moreover, following a period of subnormal consumption it may be presumed that a greater need has accumulated for durable commodities than for perishable commodities, and for luxuries than for necessities.

2. But even though it may be clear that a substantial need for the commodity exists, the need will not develop into increased demand unless both the power and the willingness to buy are present. With respect to commodities ready for personal rather than for industrial consumption, data on wage payments and employment conditions will throw some light on purchasing power; but it is also important to look ahead to the prospective conditions of employment. As to purchasing power for industrial commodities, the cash position of important buyers and the credit and capital situations are significant guides. Fortunately, it is possible to ascertain whether or not credit and capital are available. The *attitude* of bankers and investors is of great importance in this connection. There may be a large supply of potential credit which is not offered by bankers and a large supply of capital which is not being invested in industry.

3. Willingness to buy depends upon such considerations as whether the price of the commodity is attractive or otherwise. A low price is not necessarily attractive. In actual practice, a price is attractive to buyers when they believe that a higher price will shortly prevail. It is at such times that larger commitments are made. Conversely, a reduction in the volume of buying will take place, not so much because the price has risen to a high level as because there is indication that it will decline. The probable price movements of substitute products will also influence buyers in making commitments in a given commodity. Moreover, the degree of confidence in the general business and political outlook on the part of industrial buyers may have a decisive influence on the volume of purchasing. One of the clearest lessons from the depression of the 1930's is that lack of confidence in the political and economic future may postpone commitments in commodity markets, even though both the need and the purchasing power be present.

There may also be discovered in the demand for certain commodities a long-time trend, which should be taken into account in estimating prospective demand. In the case of cotton, for example, the U.S. Department of Agriculture found an upward trend of demand during the period 1920–1926 which amounted to approximately eight-tenths of a cent per pound per year.[1]

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[1] U.S. Department of Agriculture, Technical Bulletin No. 50, *Factors Affecting the Price of Cotton* (Washington, D.C., U.S. Government Printing Office, 1928).

GENERAL BUSINESS CONDITIONS

General business conditions may be at times the most important influence on commodity prices. It is essential in forecasting the price of a commodity to include a general business forecast as a part of the price analysis. But it is equally essential to recognize that the prices of individual commodities are affected in different ways and in different degrees by general business conditions.[1] General conditions affect the price of a commodity only in so far as they induce changes in the supply and demand relationships in the market for the commodity. It is a necessary part of the price forecast, therefore, to ascertain as precisely as possible how the general conditions to be expected will affect the market for *this* commodity. The effect of general conditions may be approximated by statistical comparisons over a representative period, with allowance for such new factors as may have entered the picture.

OTHER FACTORS

Among the many things that must be considered in making a price forecast, three others may be cited briefly:

1. There is an emotional element in a commodity market, which, expressing itself sometimes as speculative rapaciousness and again as devastating fear, often lifts or depresses the price far beyond the limits indicated by the economics and common sense of the situation. This emotional factor should be included in the analysis, and it is usually wise in forecasting a price change to expect movement beyond the point which the economic analysis alone would suggest.
2. The bargaining situation in the market is an independent influence in price changes. In estimating the future price of a commodity, it is important to know whether the buyers or the sellers are the better bargainers.
3. A sensitive and accurate "feel" of the market, which supplies a judgment on factors that are not measurable statistically, is an indispensable element in successful price forecasting. It epitomizes the art of forecasting in contrast to the science. Ability to feel the market is based partly on native shrewdness and partly on long experience. It cannot be acquired rapidly by means of economic and statistical studies.

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[1] Comparisons of the prices of individual commodities over a period of years emphasize the great variety of price reactions to such *general* cyclical movements as may be discovered. This is one of the "two significant facts" to which Professor Mills drew attention in his study of prices during the period 1890–1925 (Mills, *op. cit.*, p. 438). Dr. Tintner concluded as a result of his study of prices in several countries covering a period of more than half a century prior to the War of 1914–1918 that "the cyclical movements are less general and more varied than is usually supposed. In several countries certain industries show a cyclical course and rhythm which is quite different from those of other industries. The international connection of the national cycles of prices is in some respects not very close. We conclude that the cyclical movement of prices is not uniform enough to be expressed in a general index number." [Gerhard Tintner, *Prices in the Trade Cycle* (Vienna, Springer, 1935), p. 80.]

REDUCING THE COSTS OF FOOD DISTRIBUTION

BY A. C. HOFFMAN AND F. V. WAUGH

Where does most of the consumer's food dollar go—to the farmer or to the middleman? Is the spread between the farm price and the retail price justified or not? What part is played in this spread by wage rates, by profits, by efficiency or inefficiency in business methods, by consumer demands for services? What are the possibilities for reducing costs within the framework of the present marketing system? What about cooperative marketing, direct marketing, terminal wholesale facilities, new developments in retailing? Are there possibilities for reducing costs through a rather complete reorganization of the whole marketing system or large segments of it? Would such a method be consistent with our conception of free enterprise and competition? Here is a thoughtful and illuminating discussion of all of these questions.

The marketing spread between farmer and consumer has always been a matter of keen public interest and not a little criticism. To many people it has seemed unreasonable that on an average the farmer receives only about 40 percent of the price paid for food products by the consumer. This situation has been variously ascribed to monopoly, to high wage rates, to inefficiency, to a wasteful increase in expenditures for competitive selling, as well as to numerous other factors. Ways and means of reducing marketing spreads have consequently taken many forms and have received the attention of governmental agencies for many years. But there is still a rather widespread misunderstanding of why marketing charges are as high as they are and what is necessary to effect significant reductions.

Let us see at the outset what the trend of food margins has been during the last 25 years. The Bureau of Agricultural Economics has compiled figures to show the retail cost to the consumer as compared with the farm value of 58 food products in the amounts purchased annually by a typical workingman's family (Table 1). The difference between the two represents roughly the charges made for processing, transporting, and distributing this quantity of foods to the consumer. These data should not be taken as exact measures of marketing spreads, but they are believed to be accurate enough to warrant several important conclusions.

The first thing to be noted from Table 1 is that marketing charges represent a large and increasing part of the price paid for food products by the consumer. During 1913–1917 the average annual retail cost of 58 foods for a typical workingman's family was $285, of which the farmer received $157. As of 1938, the same bill of goods cost the purchaser $321, of which the farmer received $130. The spread between the farm and retail value of these goods thus increased

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Source: U.S. Department of Agriculture, *1940 Year Book of Agriculture, Farmers in a Changing World* (Washington, D.C., U.S. Government Printing Office, 1940), pp. 627–637.

TABLE 1

RETAIL VALUE, FARM VALUE, AND MARGINS OF 58 FOOD PRODUCTS, 1919–1938

Period	Retail Value (dollars)	Farm Value (dollars)	Marketing Spread (dollars)	Farmer's Share of Consumer's Dollar (percent)	Index of Hourly Wages (1926 = 100) (percent)
1913–1917	285	157	128	55	48
1918–1922	437	227	210	52	88
1923–1927	400	187	213	47	98
1928–1932	361	154	207	43	96
1933–1937	317	130	187	41	90
1938	321	130	191	40	102

from $128 to $191, while the farmer's share of the retail price decreased from 55 to 40 percent.

The first inclination is to say that here certainly is evidence that the marketing system is becoming increasingly monopolistic or increasingly inefficient or both. But let us look a little closer to see what comprises these marketing spreads, and why they behaved as they did.

FACTORS AFFECTING MARKETING SPREADS

Changes in food margins from year to year are to be explained by one or more of the following factors: (1) changes in hourly wage rates and other cost factors; (2) changes in profits and rates of return to capital invested in marketing enterprises; (3) changes in the efficiency of the marketing system; and (4) changes in the amounts and kinds of marketing services rendered.

WAGE RATES

Of these four factors, the first is by far the most important in explaining changes in marketing spreads during the last 25 years. The reason is simply that most of the charges for getting food products from the farm to the consumer are made up, either directly or indirectly, of wages. This being the case, one would expect to find a close relationship between changes in hourly wage rates and food margins. That such a relationship does indeed exist is obvious from Table 1. Hourly wage rates have more than doubled during the last 25 years, which is the chief explanation of why food margins widened as they did.

This brings us to the first choice with which we are confronted in any effort to reduce marketing spreads significantly: Either the amount of labor required to process and distribute food products must be decreased by means of increased efficiency, or the wage rate per hour must be reduced.

It goes without saying that in general the objective of public policy ought to be to reduce marketing costs by the former method rather than by wage cutting.

Any reduction in wage rates would of course affect the farmer in two ways. Insofar as it curtailed consumer purchasing power for food products, the farmer would be adversely affected. On the other hand, the farmer stands to gain directly from any measures that reduce marketing costs. From the farmer's standpoint, it is not easy to say which of these considerations is the more important. But from the public standpoint, which takes account of the interest of all groups, it is obvious that a reduction of marketing costs by means of wage cutting alone represents no net social gain, but merely a transferring of advantage between different economic groups.

PROFITS

A second component of the spread between farmer and consumer is the profits or earnings of capital invested in marketing enterprises. The notion is not infrequently held that exorbitant profits are largely responsible for the present width of this spread and that the solution is merely to force middlemen to disgorge their profits. Unfortunately the matter is not so simple as this.

The profits of some of the leading food corporations and the relation of these profits to total marketing spreads are shown in Table 2. The ratio of earnings to capitalization—which gives a close approximation to the rate of return on invested capital for the companies involved—has varied from as high as 23.9 percent for the grocery chains in 1928 to as low as 0.4 percent for the large meat-packing concerns in 1932. At no time in the last 15 years have the meat packers netted more than 6 percent on their investment, which makes it difficult to establish a case against them on the grounds that their profits have been excessive. On the other hand, the corporate grocery chains at one time were among the most profitable enterprises to be found anywhere in the country. They enjoyed these profits, however, not because they had a monopoly of

TABLE 2

RATIO OF EARNINGS TO CAPITALIZATION AND PROFIT MARGINS OF LEADING GROCERY CHAINS, DAIRY COMPANIES, AND MEAT PACKERS, 1928, 1932, AND 1936

Year	Ratio of Earnings to Capitalization *			Profit Margins †		
	5 Grocery Chains (percent)	4 Dairy Companies (percent)	4 Meat Packers (percent)	5 Grocery Chains (percent)	4 Dairy Companies (percent)	4 Meat Packers (percent)
1928	23.9	18.0	5.5	3.1	7.3	2.1
1932	14.7	7.1	0.4	2.9	4.8	0.2
1936	11.5	10.0	5.6	2.1	4.4	2.0

* Earnings represent the amount of money available for dividends on stocks, interest on bonded debt, and Federal income taxes. Capitalization represents the sum of the outstanding stocks, surplus reserves, and long-term debt.

† The profit margin is computed by dividing the earnings of a corporation by its dollar sales.

retail food distribution, but mainly because their competitors were unable to match them in distributive efficiency. In this connection it is significant that chain-store profits have fallen steadily as competition between the chains themselves has increased and as the independents have been able to meet them on more equal terms through their own voluntary and cooperative associations.

More significant for our present purpose than the ratio of earnings to invested capital is the profit margin. The profit margin is computed by dividing the earnings of a corporation by its dollar sales. It therefore shows how important these earnings are as a component of marketing spreads.

It is evident from the profit margins as shown in Table 2 that earnings do not represent a very large part of the margin between farmer and consumer. Out of every dollar of sales made by the 5 leading food chains in 1936, only about 2 cents went to the capital invested in these enterprises. For the big dairy companies and meat packers, the corresponding figures are 4.4 cents and 2 cents, respectively.

Obviously the total marketing spread would not be greatly reduced even by the complete elimination of all earnings to capital invested in food enterprises. For most food products probably not over 5 percent of the retail selling price is represented by the combined earnings to capital at all stages in the marketing process. To suggest that we must look elsewhere than at profits is not to imply that any savings, however small, are unimportant; and certainly it is not meant to condone an exorbitant rate of profit derived from monopolistic or unfair trade practices. The point is that other factors such as wage rates, material costs, and the over-all efficiency of the marketing system are considerably more important than are profits in the determination of marketing spreads.

Marketing Efficiency and Increase in Marketing Services

The charge most commonly made against the marketing system is that it is inefficient and becoming more so. The increase in absolute marketing spreads, together with the fact that the farmer's share of the consumer's dollar has tended to decrease, is often cited as evidence of this. Taken by themselves, however, neither of these things gives any direct measure of efficiency as that term is properly used.

If the farmer were to process his own products, transport them to market, and sell them direct to the consumer, there would of course be no margin between him and the consumer and he would get 100 percent of the latter's dollar. Obviously this would not be an efficient way to market most farm products, and for some of them it would be patently impossible. The proportion of the consumer's dollar received by the farmer, then, is not a measure of efficiency but rather of the degree to which farmers concentrate on the business of production rather than on marketing. Some farm products—for example, eggs that are produced near the point of consumption—do not require expensive processing or transportation. The farmer selling such products will normally receive a much larger share of the consumer's dollar than one producing peas for canning, for instance, even though both products are marketed with equal efficiency.

It is generally agreed that consumers receive more in the way of marketing services today than they once did. Examples of this are better grading and standardization, more convenient packages, and added processing. It is impossible even to estimate how much has thus been added to marketing costs. But so long as these things add to consumer satisfaction, it is self-evident that any resulting increase in the spread between farmer and consumer does not mean that the marketing system has to that extent become less efficient.

From the social standpoint, efficiency ought to be measured in terms of the amount of labor and capital required for the performance of any given marketing operation. The amount of labor required should be clearly distinguished from the wage rate or the compensation paid to labor for its services. Thus the marketing spread might increase either because more labor and capital are used for a given operation or because labor and capital are better paid. The first would be evidence of growing inefficiency but not the second. As we have seen, the increase in marketing spreads during the last 25 years is to be explained largely by the increase in hourly wage rates. But it does not follow that the marketing system is less efficient in terms of the amount of productive resources used per unit of marketing services rendered.

As a matter of fact, there is some evidence to indicate that food distribution is becoming more, rather than less, efficient. One thing which points in this direction is that food margins have not increased in proportion to the increase in hourly wage rates despite the fact that consumers are receiving as much in the way of marketing service as they ever did.[1]

Still another thing should be kept in mind when considering marketing efficiency—the distinction between those marketing costs or expenditures made for the purpose of satisfying demand and those made for the purpose of influencing it in favor of a particular firm's product. Most costs incurred in connection with the physical handling of the commodity such as assembling, processing, transporting, and storing are of the former sort. So also are part of those for selling and transferring ownership of commodities at various stages in the marketing process. But it is also true that many—though not all—of the expenditures for salesmen's salaries, brokerage fees, and brand advertising are made for the purpose of influencing the buyer to patronize a particular firm or to use a particular brand or type of commodity. Insofar as expenditures of this kind contribute to the creation of new wants, larger total sales, and reduced production costs, they serve a socially necessary and useful purpose. But if the effect is merely to take business from one firm and give it to another, then clearly there is no net social gain but only a transfer of advantage between individual firms. We should, therefore, take care to distinguish between the overall efficiency of the marketing system and that of individual firms, since the two are not necessarily synonymous.

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[1] Too much significance cannot be attached to the varying ratio between wage rates and food margins as a precise measure of efficiency, because the ratio of labor to capital may also have changed. There is no way of estimating the change in the ratio of labor to capital used in food distribution, but probably it has not been sufficient to invalidate the above conclusion.

REDUCING MARKETING COSTS WITHIN THE FRAMEWORK OF THE PRESENT SYSTEM

How much marketing costs can be reduced depends largely on how far we are willing to go in reorganizing the marketing system. Many gains have been and can be made within the framework of the present system. Improvements in the efficiency of individual firms, cooperative marketing, reorganization of terminal wholesale facilities, changes in types of retail stores—all of these offer possibilities for some reduction in marketing costs without any drastic reorganization of the present system of food distribution. But not infrequently the savings possible by these means are exaggerated in the public mind, with the result that there is disappointment when they do not come up to expectations.

Most of the efforts on the part of the farmers themselves to reduce marketing costs have been made by means of cooperative-marketing organizations. For the most part, these ventures have been confined to the processing and marketing operations at the producer end of the marketing system. Outstanding examples of the progress in cooperative marketing are, of course, the thousands of local cooperative creameries, grain elevators, cotton gins, livestock-shipping associations, fruit-packing plants, etc.

It goes without saying that the farmers' cooperative movement has led to great improvement in the local marketing sphere within which it has mainly operated. It has resulted in larger and more efficient local plant facilities, a better competitive situation, improved quality, and various other gains calculated to improve returns to member farmers. . . . But it must also be said that the costs of these local marketing functions represent only a small part of the total marketing spread, so that the greatest possible gains to be made here do not bulk large in relation to the retail price of the commodities involved. The cost of making butter, for example, might be reduced as much as 1 or even 2 cents per pound within the creamery; and the local costs of handling a bushel of wheat by as much as several cents. But important as such savings are to the farmers who receive them, it is obvious that more than this is necessary if the total cost of marketing is to be greatly reduced.

Greater potential gains are to be made in the field of food processing and in the terminal and wholesale markets, but even here it is easy to overstate what might be done without a complete reorganization of the marketing system. The most significant development affecting the terminal marketing of most farm products is the tendency toward direct marketing—as, for example, the selling of livestock direct to meat packers or the sale of fruits and vegetables by growers to chain-store systems. In effect this has meant the elimination of one or more specialized intermediaries at some point in the marketing system.

Elimination of the broker or the commission man does not mean that marketing spreads are reduced by the amount of the fees or margins formerly taken by these agents. Direct marketing involves some compensating costs on its own account, and in some cases these may be almost as great as those costs which it displaces. Generally speaking, however, direct marketing does appear to have led to some economies, particularly by mass distributors who no longer have need for the services of specialized intermediaries between them and the producer.

Among the most inefficient and disorganized terminal wholesale facilities are those for fresh fruits and vegetables. In most of our large cities, these facilities are antiquated, ill adapted to the handling of motortruck receipts, and altogether inadequate for the efficient wholesaling of perishable produce under modern conditions. As a result, waste and spoilage is higher than it should be, intracity cartage costs are excessive, and the margins taken by wholesalers and jobbers are somewhat wider than they might be if modern market facilities were provided. Studies made by the Bureau of Agricultural Economics indicate that savings approximating 2 or 3 percent of the retail price of perishables are possible within the terminal wholesale market.

Most important of all marketing functions from the standpoint of the costs involved is retailing. Because of its remoteness from the farmer, the retail function is sometimes overlooked when ways and means for reducing marketing costs are under consideration. In selling nearly all farm products, the retail margin is the largest single element in the marketing spread, and in many cases it is larger than all other marketing costs combined. The retail margin for fruits and vegetables, for example, commonly amounts to 30 to 35 percent of the retail price; for meat products, 25 to 30 percent; for bread, 20 percent. This does not mean that the retailer is less efficient in his operations than handlers at other stages in the marketing process or that his profits are necessarily exorbitant in relation to his labor and invested capital. But it does mean that here is one of the most likely points at which to effect significant savings in food distribution.

The outstanding development in food retailing has been the growth of the corporate grocery chains and, in recent years, of voluntary and cooperative chains of independent retailers. The changes brought about in food retailing as a result of this development are of two kinds: (1) those resulting from the integration of the wholesaling function with that of retailing; and (2) changes in the operation of the retail grocery store itself.

Next to the function of retailing itself, some of the most costly links in the marketing system are those between the processor and the retailer. The key to many of the advantages possessed by chain systems lies in the fact that they have dropped some of these links by the integration of successive marketing functions within a single firm. Nearly all of the chains have set up their own wholesaling establishments to service their retail units, and the larger systems have gone actively into country assembling and processing of many food products. In consequence of this, their stocks move toward the consumer without the numerous and costly bargaining transactions and selling operations necessary to move goods in the regular channels.

Equally important are the changes which mass retailing has brought about within the retail store itself. The emphasis of chain stores as well as of many independents has been on rapid turnover, larger volume per store, and the application of labor-saving methods—notably the self-service feature. The corporate chains took the initiative along these lines, but in recent years the voluntary and cooperative chains have not been far behind in the application of many of these cost-saving features.

How much mass retailing has contributed toward reduced marketing costs it is of course impossible to say. Data compiled by the Federal Trade Commission in connection with its chain-store inquiry indicated that, in the four cities studied, the chains were selling at prices approximately 7 percent below those of their independent competitors. Numerous studies made by other agencies confirm this general relationship between the prices of chains and those of independents, although there are, of course, many individual exceptions to these averages. It is probable that the reduction in food costs brought about as a result of mass retailing is even greater than these price differentials would indicate, since all retailers must follow the lead of their low-price competitors to some extent if they are to stay in business in competition with them.

Another important development in food distribution is the introduction of new low-cost methods of retailing, notably the supermarket. The essential features of the supermarket are tremendous store volume (often amounting to 10 or 20 times that of the average grocery store), low rent and store overhead, and a reduction in store labor by means of customer self-service. Within the short span of a few years, stores of this type have become an important factor in the grocery trade, particularly since the older grocery chains have begun converting their retail units into markets of this type.

Somewhat the same general idea is embodied in the milk depots recently set up in several large cities at which milk is sold at greatly reduced prices to those willing to forego the regular service of doorstep delivery for this product. All low-cost marketing developments of this kind are likely to have a special appeal for those whose income is limited or who prefer lower prices to extra marketing services, and they ought to be permitted to develop in accordance with the wishes of those who use them.

OVER-ALL REORGANIZATION OF THE MARKETING SYSTEM

Thus far we have discussed only those savings which can be made within the framework of the present marketing system. To a considerable extent, however, all of these leave untouched one of the main causes of high marketing costs—the duplication of processing, transportation, and marketing facilities arising out of competition itself. We have indeed made great progress in improving the efficiency and reducing the costs of individual firms; but this has not resulted in a proportionate improvement in what might be called the over-all efficiency of marketing because the nature of our marketing system is such that no limitation has been placed on the number of firms or the quantity of labor and capital used in food distribution.

It is not possible on the basis of present information even to approximate how much the needless duplication of marketing facilities at all stages of food distribution adds to marketing spreads. But it can be asserted positively that the number of retailing, wholesaling, processing, and assembling establishments has multiplied out of all proportion to what would be needed if food distribution were organized on what might be called a social-engineering basis.

The number of grocery stores, for example, has increased from 160,000 in 1900 to 355,000 in 1935. Population per store has decreased in this same period from 486 to 358. Part of this increase in retail facilities is due to the fact that a larger proportion of the population now lives in cities and requires more in the way of retail facilities. But it also signifies a growing excess of retail facilities, the cost of which must be reflected either in wider marketing spreads than would otherwise be necessary or in a lowered rate of recompense to the labor and capital employed in retailing enterprises.

Nor is this situation confined to food retailing. To some extent at least it is to be found at every point in the marketing system. We do not need all our creameries and canneries and grain elevators to handle our present food supply. Studies have repeatedly shown that many of these plants are operating at far less than capacity and that substantial cost savings could be made if all of the supply were to move through the most efficient types of plants operating at full capacity. In general this would probably mean a substantial increase in the average size of plant and handling agencies, and it would certainly mean a reduction in numbers of handlers so as to bring the over-all capacity of the marketing system more in line with the facilities actually needed to process and distribute food products.

Generally speaking, proposals of this kind have not yet received much discussion so far as the food industries are concerned. During recent years, however, an increasing number of people are beginning to think of fluid-milk distribution in these terms. Careful students of the problem know that the costs of fluid-milk distribution are high mainly because of the duplication of pasteurizing facilities and the overlapping of milk routes and that these costs can be reduced significantly only by a fundamental reorganization of the fluid-milk marketing system. How much these costs can be reduced and whether or not the necessary measures are feasible, considering all the factors involved, is of course conjectural. A recent study of fluid-milk marketing in Milwaukee, Wis., indicates that savings of more than 2 cents per quart might be achieved through a unified, noncompetitive system of milk distribution. A gain even approximating this estimate would far exceed any saving likely to be obtained in any other way.

To achieve the maximum efficiency in food distribution by limiting the number and kind of marketing facilities to those actually needed to provide consumers with the goods and services they desire would obviously involve some fundamental changes in our present conception of free enterprise and competition. It would probably mean that some limits would have to be placed on the right of private enterprisers to erect plants and engage in marketing operations unless there was a real need for the added facilities. In some cases it might even mean the abandonment of competition as the regulator of economic forces and the substitution of public control somewhat along the lines of that now being exercised in those industries classified as public utilities. At the present time most of the food industries are too ramified and their economic units are too numerous and too separate to permit an easy transition to such a system. The thing to be emphasized, however, is that this is the general direction in which food distribution will probably have to go if the sole objective is to process and distribute food products at the least possible cost in terms of man-hours and capital equipment.

Assuming that it were possible to operate our marketing system with far less labor and capital than is now used, it will immediately be asked what is to be done with the additional productive resources thus made available for other means of employment. With many of our resources already idle, many will argue that no good purpose will be served by adding to present unemployment. If the alternative to employment, even though it be relatively unnecessary and unproductive, is no employment, then this argument indeed has considerable logic. There is, of course, nothing novel either in this contention or in the situation which has given rise to it. The same objection was raised at one time to the introduction of the power loom, the steam engine, and many of the other labor-saving instruments which are basic to our modern way of living.

The fundamental problem of how to give full and productive employment to all economic resources is beyond the scope of this article. It has generally been assumed that labor and capital displaced in one line of enterprise would ultimately find employment in another. Over the centuries this has in the main been true; but the lag has been so great and the adjustments so slow that the ultimate gains for mankind have been achieved only at the expense of great loss and suffering during the transition period.

Public Policy toward New Marketing Developments

One thing further might be said regarding the reduction of food costs. Nearly everyone pays lip service to the need for doing everything possible to reduce marketing spreads and lower the costs of food distribution. But not even governmental agencies themselves have always followed a consistent policy in this matter.

One of the economic premises on which the Federal Government was founded was that there should be free and unrestricted commerce between the States. In another article in this Year Book . . . the way in which this premise has been violated by various State and local barriers to internal trade is described in some detail. It is self-evident that this tendency cannot but result in an uneconomic use of productive resources and that it must mean some addition to the nation's food costs.

Another contradiction is sometimes to be found in governmental policy toward large-scale marketing organizations. It goes without saying that private monopoly in any of its forms is intolerable and must be abolished either by the restoration of competition or by public control of monopolized industries. Sometimes, however, governmental measures go beyond this and seek to help or preserve a particular type of marketing system on the grounds that this, rather than a possible reduction in marketing costs, is in the public interest. Examples of this are some of the State chain-store tax laws, trade-practice acts, and State and Federal legislation for resale price maintenance. It may be that, when all factors are considered, measures of this kind are in the public interest. But when their effect is to maintain food prices at levels higher than they would otherwise be, it should be frankly recognized that there may be an inconsistency between these measures and the goal of narrower marketing spreads.

COOPERATIVE MARKETING BY FARMERS

BY E. A. STOKDYK

[Farmers' cooperative marketing associations have now gained a firm foothold in the United States and are showing a remarkably healthy growth. There are 8,300 of these associations today, with 2,500,000 farmer members, doing an annual business of over $2,000,000,000. Here is an account of this significant development. The author discusses the organization, nature, and functions of farmer cooperatives and devotes a good deal of attention to analyzing their legal status. He then summarizes the present position of the cooperatives handling each of seven major types of farm products—dairy products, poultry products, fruits and vegetables, grain, livestock, wool, and cotton. Even this, as he points out, does not tell the whole story, for there are now cooperatives in the United States handling many other farm products.]

Cooperative marketing of agricultural products is a well-established economic institution in the United States. In the 1937–38 marketing season approximately 2,500,000 farmers sold more than $2,000,000,000 worth of agricultural products through 8,300 cooperative marketing associations.

In every State of the union, as well as the District of Columbia and Puerto Rico, cooperative-marketing associations are now in operation. . . . These associations are groups of farmers operating their own creameries, their own cheese factories, their own grain elevators, their own shipping associations, their own packing plants, their own sawmills, or their own sales agencies. The fundamental characteristic of a cooperative is that it is operated for the mutual benefit of its members as producers—not as stockholders. Advantages to a member accrue primarily through his patronage of the association and not because of any financial investment he may have made.

The legal status of such cooperative activity among farmers has been clarified through legislation and judicial interpretation. The legislatures in all of the

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Source: U.S. Department of Agriculture, *1940 Year Book of Agriculture, Farmers in a Changing World* (Washington, D.C., U.S. Government Printing Office, 1940), pp. 684, 686–705.

States, as well as the Congress of the United States, have outlined standards for farmers' organizations, and the courts have interpreted them in the light of the economic objectives the associations have sought to attain.

The Federal and State Governments have encouraged these cooperative enterprises through special incorporation laws, exemption from certain taxes, loans from governmental and semigovernmental agencies, and advice and assistance through research and educational institutions.

Cooperatives themselves have become recognized as educational institutions. They are a vehicle for transmitting to farmers an understanding of the numerous forces and factors that affect the economic status of those engaged in agriculture. They are also an avenue for the dissemination of current information relating to State and Federal agricultural programs. In turn, they have assisted in planning and executing such programs.

The three broad economic objectives of cooperatives—lower costs, higher quality, and better service—are likely to receive increased emphasis in the future. Some of the objectives of some cooperatives are now being attained through State and Federal control programs. A steady and solid growth in cooperative marketing may be expected as a result of experience and of the advice and assistance being rendered by governmental agencies.

The 8,000-odd cooperative-marketing associations in the United States have seen their aggregate annual business grow in recent years (1933–1938) to the 2-billion-dollar level, with 270 associations reporting sales of more than a million dollars each. According to estimates, they serve nearly 2½ million farmers (Table 1). Commodities handled include practically every type of product grown on American farms and ranches: livestock, grain, cotton, fruits, vegetables, dairy products, eggs and poultry, wool, tobacco, rice, sugar, and many other items of lesser importance.

TABLE I

NUMBER OF FARMERS' MARKETING ASSOCIATIONS, ESTIMATED MEMBERSHIP, AND ESTIMATED BUSINESS FOR THE 5-YEAR PERIOD 1933–34 TO 1937–38

Marketing Season	Associations (number)	Members * (number)	Volume of Business * (thousand dollars)
1933–34	9,052	2,464,000	1,213,000
1934–35	8,794	2,490,000	1,343,000
1935–36	8,388	2,710,000	1,586,000
1936–37	8,151	2,414,000	1,882,000
1937–38	8,300	2,500,000	2,050,000

* Estimated.

Source: Compiled from data assembled by the History and Statistics Sections, Cooperative Research and Service Division, Farm Credit Administration.

BACKGROUND OF THE COOPERATIVE MOVEMENT

Cooperative marketing as it exists in the United States today does not represent a sudden or spectacular change in the method of handling farm products. For more than half a century our farmers have participated in cooperative enterprises. As early as the 1870's, and in isolated cases even before that, groups of farmers were convinced that they could obtain certain services cheaper or better by providing these services for themselves on a cooperative basis. From that time to the present, through periods of prosperity and periods of depression, this idea has grown. In thousands of rural communities throughout the United States cooperative enterprises have been undertaken, with varying degrees of success or failure, but each experience has added to the knowledge of the cooperative way of doing business.

Many of the earlier associations have disappeared; but a few of those now active date back to the early days of the Granger movement, and over 2,000 associations have been operating continuously for more than 25 years (Table 2). These older associations are most numerous in Minnesota, Wisconsin, and Iowa. This group is composed chiefly, though by no means exclusively, of creameries and cheese factories. Many of the grain elevators now operating were formed between 1910 and 1920. Many livestock-shipping associations also were organized in that period, their organization reaching a peak about 1919.

TABLE 2

MARKETING ASSOCIATIONS CLASSIFIED ACCORDING TO AGE

Age (years)	Associations (number)	Ratio to Total (percent)
Less than 6	1,142	14
6–10	1,063	13
11–15	890	11
16–20	1,753	22
21–25	1,275	16
Over 25	2,028	24
Total	8,151	100

Source: Compiled from data assembled during the 1936 nation-wide survey of farmers' cooperatives. For a complete tabulation of the statistical data assembled during this survey see Farm Credit Administration, Bulletin No. 26.

ORGANIZATION OF COOPERATIVE ASSOCIATIONS

Cooperatives are often referred to as nonprofit organizations. This, of course, does not mean that a cooperative association does not have capital; nor does it mean that an organization of this type will never make a purchase-and-sale transaction at a profit. What it does mean is that the earnings of the association—or the savings, as they might better be called—are returned to the patrons of the organization as dividends, whether in cash or in capital equities. These dividends are called patronage dividends. Patrons may be members or nonmember users of the association's services.

Patronage dividends do not necessarily provide a good measure of the benefits derived from cooperative organizations; however, they do represent one of the tangible evidences of these benefits. A bargaining association may do much toward stabilizing a market and increasing the price paid to farmers. But this type of activity does not lend itself readily to accurate measurement. There is always the question of what the price would have been had the association not operated.

In 1936, the latest year for which complete information is available, patronage dividends returned by the marketing associations amounted to $17,342,750 (Table 3). This figure, of course, does not represent the total savings effected by cooperatives during that year. Part of the earnings were retained to build up the farmers' investment in their associations. Furthermore, many cooperatives have a policy of rendering services as near cost as possible and do not attempt to build up any earnings or surplus for later distribution to their members.

TABLE 3

PATRONAGE DIVIDENDS PAID IN 1936 BY MARKETING ASSOCIATIONS OF EACH COMMODITY TYPE

Commodity Type	Associations Paying Dividends (number)	Patronage Dividends Paid (dollars)
Fruits and vegetables	350	7,529,850
Grain	1,121	3,035,200
Dairy	647	2,915,950
Poultry	43	2,044,900
Cotton	147	1,003,750
Livestock	227	583,950
Miscellaneous selling	89	224,900
Wool	15	4,250
Total	2,639	17,342,750 *

* In addition to the $17,342,750 returned by the marketing associations, $8,037,250 was returned by purchasing associations, making a grand total of $25,380,000.

Source: Compiled from data assembled during the 1936 nation-wide survey of farmers' cooperatives.

If an association is to be truly cooperative, the control must be in the hands of its members. Equality among the members in the control of the affairs of the association is one of the oldest principles of cooperative endeavor. The association is managed by a board of directors selected from the ranks of the farmer-members. The one-man-one-vote rule is generally accepted, but it is not indispensable. Sometimes equality in voting among the members of a capital-stock association is furthered by limiting the number of shares a member may own. A few associations use patronage as a basis of voting rights (Table 4).

TABLE 4

MARKETING ASSOCIATIONS CLASSIFIED ACCORDING TO BASIS OF VOTING

Basis of Voting	Associations (number)	Ratio to Total (percent)
One member, one vote	6,976	86
Stock, or other forms of equity	1,003	12
Patronage	117	1
Other and unknown	55	1
Total	8,151	100

Source: Compiled from data assembled during the 1936 nation-wide survey of farmers' cooperatives.

Eighty-six percent of all the farmers' cooperative-marketing associations operating in the United States use the one-member-one-vote principle, while in 12 percent of the associations voting privileges are based on the ownership of stock or other types of membership equity. This latter practice is most prevalent in Illinois and Missouri.

In 117 marketing associations, most of which are located on the Pacific Coast, voting privileges are based either on patronage alone or on a combination of patronage and membership. Where a combination of patronage and membership is used, the usual procedure is to allow each member one vote plus additional votes based on his patronage of the cooperative.

COOPERATIVE MARKETING AS AN EDUCATIONAL FORCE

An examination of the history of American agriculture, especially during the past 25 years, will show that probably no influence has been so potent in the economic education of farmers as their own efforts in cooperative marketing. In many cases these efforts have been apparently unsuccessful, but the very attempt on the part of the farmers to solve their problems together has taught them basic economic truths. For example, such experience has tended to teach farmers how the law of supply and demand actually works, how the export market affects the particular commodities in which they are interested, and the relation of a sound condition in industry to agricultural prosperity. Much of this knowledge has come incidentally through their struggles to develop a cooperative-marketing system for their products.

The process of education in cooperatives comes largely through the way in which they function as democratic organizations. Experience in the operation of these associations has shown that they cannot succeed without full membership understanding, and this requires that members be kept informed on the problems of their industry by their hired executives. As a result, these associations hold membership meetings, issue publications, conduct market tours and grading demonstrations, hold cooperative institutes, and in many other ways stimulate thinking.

The operation of cooperative-marketing associations teaches farmers that agriculture is primarily a form of business. Many of the associations have even gone so far as to directly encourage farmers to keep detailed records on their individual business operations. For example, the many poultry associations encourage their members to keep records on egg production, while the dairy cooperatives often encourage similar studies of milk production. The annual reports and statistical information developed and distributed by such associations are of great importance in teaching business principles to farmers.

Cooperative-marketing associations have also taught farmers that the problem of marketing is closely related to the problem of production, since the efficient marketing of any agricultural product depends upon the adjustment of supply to demand. These associations have been forced to study the market to determine the demand for particular products. They have found from experience that the demand for agricultural products can be increased by an improvement in production methods that results in products of higher quality. The significance of such a cooperative association as the California Fruit Growers' Exchange is, in effect, as great in the field of quality improvement of its products as in the actual process of selling.

In many cases farmers are not willing to undertake general reforms in agricultural practices without a definite economic incentive for such action. Cooperative-marketing associations have in many cases provided this incentive through the assurance of higher returns or patronage dividends as a result of following recommendations. The cooperatives' method of paying returns on the basis of quality has directly furthered quality improvement and also standardization of grades.

Thus, cooperative effort on the part of farmers has had a direct effect in improving the quality of products placed on the consumer's table. For example, the large egg-marketing associations have taken the lead nationally in raising the quality of eggs, while cooperative creameries have raised the general quality of butter. The fluid-milk bargaining associations have likewise done much to raise the hygienic standards for fluid milk. Again, until the advent of cotton cooperatives, cotton was largely sold as just cotton. There was little encouragement to growers to produce cotton of any particular grade and staple length, although cotton was sold to cotton mills on a grade and staple-length basis. Cotton cooperatives have done much to change this situation through premiums and discounts based on the ultimate commercial value of the product. Although much remains to be done in this direction, it is true that, through the activities of these associations, cotton growers, both members and nonmembers, have become conscious of the importance of staple length. Likewise through efforts in cooperative marketing farmers have been made aware of the importance of the protein content of wheat.

Until farmers attempt to market their products in cooperation they have little knowledge or experience of market abuses which may greatly reduce the economic value of their products. When they undertake a marketing program of their own, these abuses quickly come to the surface, and through the mechanism of the cooperative marketing association become known to the members. Some of the valuable legislation designed to remove marketing abuses and certain Federal services established for the same purpose have come about through the insistence of cooperative groups that these abuses be abolished. Cooperative-marketing associations, for example, played an important part in bringing about the enactment of the Packers and Stockyards Act, in improving the Federal crop-reporting service, and in securing more adequate statistical information on agricultural products and marketing, as well as in the enactment of Commodities Exchange legislation.

Cooperatives also serve an important function in transmitting information on the many forces that affect the economic status of farmers. The State colleges of agriculture, the United States Department of Agriculture, and the Farm Credit Administration disseminate their findings through cooperatives as well as through other agricultural agencies.

Cooperatives have taken an active part in the formulation and execution of State and Federal surplus-control programs and marketing agreements. In fact some of the most successful of such programs owe a large part of their success to cooperative-marketing associations.

Functions of Cooperatives

The three broad economic objectives of lowering costs, improving quality, and rendering improved service are common to most cooperative associations. Some have more specific objectives, and a few have attempted to obtain what were considered reasonable prices by limiting the quantity of goods moving into the ordinary channels of trade. A general objective—that of increasing farmers' bargaining power—is either stated or implied in all cooperative structures.

The majority of cooperative associations handle products sold in competitive markets where prices are made through the bids and offers of numerous buyers and sellers. They deal in commodities produced in many areas under highly competitive conditions. As a consequence, they can exert little influence on wholesale prices. They do, however, have a marked influence on local prices by narrowing the margin between wholesale or terminal-market prices and local prices. The method employed is to operate efficient local units, whether creameries, elevators, packing houses, or livestock-shipping associations. At the same time, the cooperatives have aimed to furnish more and improved marketing services by facilitating the delivery and handling of members' products.

After a cooperative has become established and attains efficient operation, its existence forces competitors to narrow their margins and render better service. Then the objective of the association becomes one of maintaining a reasonable margin and satisfactory services. In many agricultural areas in the United States cooperatives handling staple products have accomplished about all that can be expected in the way of narrowing the spread between terminal and local prices, improving marketing services, and improving the quality of their products. In some areas, however, there is need for the establishment of cooperatives to set the competitive pace. In still other areas there is an opportunity for cooperatives to correct an unsatisfactory competitive condition caused by an excessive number of dealers, each operating with a small volume and high overhead costs. In a few areas there is a chance for producers to increase their returns by forming cooperatives to utilize improved techniques or equipment which proprietary dealers are slow to adopt because of present investments.

Cooperatives that handle specialty crops usually have one or more objectives not common to those that handle staples. These include (1) the expansion of markets through advertising, (2) the timing of sales to the periods of strong and slack demand, (3) the distribution of a given available supply among markets to put equal pressure on all markets, (4) the promotion of reasonable dealers' margins, and (5) the adoption of grades and packages to meet the demands of various income groups.

It is likely that these objectives will receive increased emphasis in the future, because with the advent of State and Federal programs some of the problems which cooperatives formerly undertook singlehanded are now undertaken by the entire industry. This development has had a wholesome effect on cooperative activity, because it makes a distinction between marketing problems and the surplus problem. Some cooperatives have attempted to handle a surplus for an entire industry, but they have found that such activities placed undue burdens on their members, upon whom the entire cost of the removal of the surplus fell while nonmembers benefited equally. As a result, with few exceptions, cooperatives have abandoned surplus-control programs, and where such action is advisable they now insist that such programs be undertaken by the industry as a whole.

Some surplus-control programs have tended to weaken cooperative activity. On the other hand, control programs that are primarily volume-proration programs and leave the function of pricing to those who handle the products have stimulated associations that were efficient and weeded out the inefficient.

LEGAL STATUS OF COOPERATIVE MARKETING

During the early history of cooperative marketing in the United States cooperatives employed the corporate structure of private business. Some still do today. However, certain difficulties that arose in the maintenance of patron control of voting rights and in the conduct of business operations made it desirable for cooperatives to seek special incorporation acts which would permit restrictions on the transfer of shares and allow the distribution of earnings on a patronage basis.

Beginning in 1865, when the first cooperative statute, although not applicable to farmers, was enacted in Michigan, increasing legislative recognition has been accorded the special status of cooperative associations. The early statutes retained the capital-stock concept that prevailed in the field of corporations organized for profit, and it was not until 1895, when the California nonstock law was adopted, that the organization of nonstock cooperative associations was authorized by statute.

Each of the 48 States now has statutes for the incorporation by farmers of cooperative-marketing associations. These statutes have been construed by the courts as desirable and essential for organizations of a nonprofit character dealing in agricultural products. Generally speaking, the courts have come to recognize that cooperative-marketing associations are formed and are intended to operate on somewhat different principles from general corporations and that the members have, aside from their monetary interest, a common interest in the objects for which the associations are formed.

The comparatively few cooperative rights conferred by the early statutes have been greatly expanded as a more widespread recognition has been obtained of the public need for and benefit from cooperative efforts, and as experience in cooperative activities has demonstrated the necessity of additional legal safeguards and new procedures for accomplishing the proper purposes of cooperative associations.

In a large and increasing number of cases, farmers' cooperatives have availed themselves of the privileges and safeguards afforded them by these laws. Of the 8,151 farmers' cooperative marketing associations operating in the United States in 1936, 74 percent were incorporated under cooperative laws, 14 percent were incorporated under general corporation laws, and 12 percent were unincorporated (Table 5).

TABLE 5

MARKETING ASSOCIATIONS CLASSIFIED ACCORDING TO LEGAL STATUS

Law under Which Incorporated	Associations (number)	Ratio to Total (percent)
Cooperative stock	4,166	51
Cooperative nonstock	1,904	23
General corporation	1,115	14
Not incorporated	966	12
Total	8,151	100

Source: Compiled from data assembled during the 1936 nation-wide survey of farmers' cooperatives.

The cooperative character of an association does not depend upon whether it is incorporated under cooperative laws. Unincorporated associations or even associations incorporated under general corporation laws may be thoroughly cooperative if properly organized and operated. Fundamentally, the cooperative association must be operated for the benefit of its members as producers, not as stockholders.

THE CAPPER-VOLSTEAD ACT

The legal status of cooperative associations was by no means secure from the start, and much litigation and legislative effort was required before it was made so. Thus it was not made clear until 1922, with the enactment of the Capper-Volstead Act,[1] that a cooperative association was not, by reason of the manner in which it was organized and normally operated, a combination in restraint of trade in violation of the Federal antitrust statutes, even though no Federal court had so held. The Sherman Act did not exempt cooperative associations from its provisions, and although the Clayton Act [2] recognized in a sense the nature of cooperative associations as such, it applied only to nonstock associations and afforded no protection for certain established practices of cooperatives. One of the distinct contributions of the Capper-Volstead Act was the definition of a cooperative association which it contained. This definition has served generally as a standard for cooperative organizations and activities.

In the meantime, in some of the States, the courts had held that the contracts or bylaws of cooperative associations operated to unduly restrain trade,[3] or that the association was a combination in restraint of trade, and was unlawful under the State antitrust laws.[4] Subsequent legislation and court decisions have led to a reversal of the holdings in these earlier cases.[5]

As a result of court decisions and statutory provisions, it is believed at the present time that a cooperative association which is properly organized and functions in a normal manner is not acting in violation of the antitrust statutes. It should be borne in mind, however, that the antitrust statutes do apply to cooperative associations, and if they engage in prohibited practices, such as boycotting, or in other activities the effect of which is in fact unduly to restrain trade, they may be prosecuted or held liable in damages in the same manner as other business enterprises.[6]

SPECIAL STATUTES

As previously indicated, it may be said that the special character and functions of cooperative associations have received rather full recognition by both Federal and State Governments. Thus, a cooperative association which meets the statutory requirements is exempted from the payment of income [7] and other Federal taxes and from the necessity of registering its securities with the Securities and Exchange Commission.[8]

A cooperative association is also entitled to receive advice and service from the Cooperative Research and Service Division of the Farm Credit Administration [1] and, upon meeting the statutory requirements, is entitled to borrow from the banks for cooperatives; [2] is entitled to representation on boards of trade under the Commodity Exchange Act; [3] and is also entitled to certain exemptions under the Motor Carrier Act.[4]

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[1] 42 Stat. 388, 7 U.S.C. 291.

[2] 38 Stat. 730, 15 U.S.C. 12.

[3] *Reeves v. Decorah Farmer's Cooperative Society*, 160 Ia. 194, 140 N.W. 844; *Burns v. Wray Farmers' Grain Company*, 65 Colo. 425, 176 P. 487.

[4] *Ford v. Chicago Milk Shippers' Association*, 155 Ill. 166, 39 N.E. 651.

[5] *Clear Lake Co-op. Livestock Shippers' Association v. Weir*, 200 Ia. 1293, 206 N.W. 297; *Rifle Potato Growers' Cooperative Association v. Smith*, 78 Colo. 171, 240 P. 937; *Milk Producers' Marketing Company v. Bell*, 235 App., 222.

[6] *United States v. Borden*, 308 U.S. 188, 60 S. Ct. 182, 84 L.E. 143; *State v. Standard Oil Company et al.*, 130 Tex. 313, 107 S.W. (2d), 550; *Hy-Grade Dairies v. Falls City Producers' Association*, 216 Ky. 25, 86 S.W. (2d), 1046.

[7] 52 Stat. 480, 26 U.S.C. 101, par. 12.

[8] 48 Stat. 74, 15 U.S.C. 77c.

In addition, the special nature of cooperatives has received recognition in the Soil Conservation and Allotment Act as Amended,[5] the Robinson-Patman Act,[6] the Agricultural Marketing Agreements Act of 1937,[7] and other Federal statutes.

Cooperative associations, like other corporations, are the creatures of statutes, and at present the cooperative acts of the 48 States, generally speaking, give associations properly incorporated thereunder rather broad powers for organization and operation and a certain latitude in such matters as financing, membership control, marketing contracts, distribution of earnings, and the character of business which may be transacted. In many of the States, by statute, an association may recover liquidated damages for breach of its contracts [8] and injunctive relief against its members and against others for interfering with the performance of the marketing agreements of members.[9]

Further recognition of the special character of the cooperative associations is reflected in State statutes exempting such associations from various tax and licensing statutes.

Many of the State statutes have copied the Bingham Cooperative Marketing Act of Kentucky [10] and contain provisions either identical with or similar to provisions of the Kentucky act. Under these statutes there has developed and is developing a body of case law that is becoming rather well defined and establishes the rights and liabilities of cooperative associations under stated circumstances.

Since cooperative associations are usually incorporated, the general corporation statutes and court decisions on corporate procedure and practices are frequently applicable to situations in which the special character of a cooperative association is not directly in question, and many cases concerning cooperative associations treat such associations just like other corporations.

Although much remains to be accomplished in improving and perfecting the cooperative statutes, and particularly the corporate structures, forms, practices, and contracts of individual associations, it may be said that cooperative associations have established a definite legal status in both Federal and State law, and have won general recognition and understanding of their special character and functions.

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[1] 44 Stat. 802, 7 U.S.C. 455.

[2] 48 Stat. 262, 264, 49 Stat. 317; 50 Stat. 717, 12 U.S.C. 1134*c*.

[3] 49 Stat. 1491, 7 U.S.C. 1.

[4] 49 Stat. 545, 49 U.S.C. 303 (*b*) (4*b*).

[5] 52 Stat. 31, 16 U.S.C. 590.

[6] 49 Stat. 1526, 15 U.S.C. 13.

[7] 50 Stat. 246, 7 U.S.C. 601.

[8] *Milk Producers' Association of San Diego County v. Webb*, 97 Cal. App. 650, 275 P., 1001.

[9] *Local Dairymen's Cooperative Association v. Potvin*, 54 R.I. 430, 173 A., 535.

[10] Acts of Kentucky, 1922, Ch. 1, Carroll's Ky. Statutes, Baldwin's 1936 Revision, S883f 1-41.

THE PRINCIPAL TYPES OF FARMER COOPERATIVES IN THE UNITED STATES

DAIRY PRODUCTS

In volume of business and number of members, dairy cooperatives lead those of all other commodity groups. Scattered throughout 45 States are more than 2,400 dairy cooperative organizations selling milk, cream, butter, cheese, and other dairy products for almost three-quarters of a million farmers. . . . Approximately 48 percent of all the fluid milk, 39 percent of all the butter, 25 percent of all the cheese, and lesser amounts of other dairy products pass through the hands of cooperative-marketing organizations at one stage or another as these products move from farmer to consumer. During the last 5-year period, the number of cooperative dairy marketing organizations increased from 2,286 to 2,421, and during this same time sales increased from $380,000,000 to $687,000,000 (Table 6).

TABLE 6

NUMBER OF DAIRY MARKETING ASSOCIATIONS, ESTIMATED MEMBERSHIP, AND ESTIMATED BUSINESS FOR THE 5-YEAR PERIOD 1933–34 TO 1937–38

Marketing Season	Associations (number)	Members* (number)	Volume of Business * (thousand dollars)
1933–34	2,286	757,000	380,000
1934–35	2,300	750,000	440,000
1935–36	2,270	720,000	520,000
1936–37	2,338	656,900	557,100
1937–38	2,421	700,000	686,000

* Estimated.
Source: Compiled from data assembled by the History and Statistics Section, Cooperative Research and Service Division, Farm Credit Administration.

Oldest of the dairy associations are the cooperative cheese factories. Concentrated largely in Wisconsin and surrounding States, 543 producer-owned plants are making each year approximately 150,000,000 pounds, or about one-fourth of all the cheese made in this country. In 1936 the output of these 500-odd plants was valued at $24,133,000. Averaging about 30 members each and with annual sales that average less than $50,000 for each association, the cheese factories are the smallest of the dairy cooperatives.

More than 200,000 dairy farmers producing milk and cream for fluid use look to cooperative organizations to find a market for these products. About 140,000 of these dairy farmers are members of fluid-milk bargaining associations, of which there are more than 100 now in operation. The others are members of associations that go a step further than bargaining, actually taking title to the milk and processing part of the supply. In some cases the milk is pasteurized, bottled, and carried to the consumers' doorsteps by the cooperative, but usually the fluid milk is sold on a wholesale basis.

The conversion of milk or cream into butter is the primary work of approximately 1,400 cooperative creameries. Through these cooperatively operated plants, farmers are selling about 500,000,000 pounds of butterfat each year. Scattered across the country from Vermont to California, cooperative creameries now are operating in at least 28 States; but, as would be expected, they are most numerous in the heavy butter-producing region comprising the North Central States. Minnesota alone has 600 such creameries, Iowa has 260, and Wisconsin 220. In each of these three States more than half of the factory-made butter comes from cooperative plants.

POULTRY PRODUCTS

The principal business of 194 associations is marketing eggs and poultry for 106,000 farmers. During the 5 years ended in 1938, the number of poultry associations increased from 147 to 194 and the volume of business from $48,000,000 to $91,000,000 (Table 7). In addition to these 194 egg and poultry associations, some 700 other cooperatives are handling poultry products as sideline enterprises. Chief among these are a number of local cooperative creameries, most of them in the Middle Western States.

TABLE 7

NUMBER OF EGG AND POULTRY ASSOCIATIONS, ESTIMATED MEMBERSHIP AND ESTIMATED BUSINESS FOR THE 5-YEAR PERIOD 1933-34 TO 1937-38

Marketing Season	Associations (number)	Members * (number)	Volume of Business * (thousand dollars)
1933-34	147	73,000	48,000
1934-35	164	85,000	54,000
1935-36	154	93,000	69,000
1936-37	180	112,500	72,000
1937-38	194	106,000	91,000

* Estimated.

Source: Compiled from data assembled by the History and Statistics Section, Cooperative Research and Service Division, Farm Credit Administration.

In California, Oregon, Washington, Utah, and Idaho, where intensive commercial poultry production has developed on a large scale, poultrymen now own and operate some of the world's largest egg, poultry, and turkey marketing associations. At least 8 associations located in this area transact an annual volume of business in excess of $1,000,000 each. The business of some of these associations exceeds the $10,000,000 level when feed and other supplies handled are included. Many progressive practices have been instituted by this group of organizations; for example, box packing of turkeys on a Government-graded basis, oil treatment of shell eggs to improve their keeping quality, and the cleaning of eggs by the sandblast process.

In the Eastern States, where the producing areas lie within easy reach of large consuming centers, the auction method of selling eggs and poultry has become very popular. In this area, 26 egg and poultry auctions are now in operation. The first of these was organized in Flemington, N.J., in 1930. Since that time additional ones have been formed in Pennsylvania, New York, Connecticut, Massachusetts, Rhode Island, New Hampshire, Ohio, Indiana, and Maryland, as well as at four other points in New Jersey. Through these associations 13,068 poultrymen in 1937 sold 947,210 cases of eggs and 172,314 crates of poultry, the combined value of which was more than $10,000,000.

In the Middle Western States, the production of eggs and poultry is a sideline enterprise on most farms, and the marketing of these products is likewise a side line with many cooperatives in this area. In contrast with the specialized and commercial poultry farms of the Far West, production is on a much smaller scale. A farm flock of not more than 100 hens is the general rule. These producers pay less attention to quality and grade and know less about the value of their eggs than the large-scale poultrymen. This situation is not particularly conducive to the development of poultry-marketing organizations as such. It is here that most of the 700 or so cooperative associations that market poultry products as a side line to the handling of other commodities are located.

The greatest development of this type has occurred in Missouri. Here the eggs and poultry are assembled through local exchanges and then moved to concentration points, where the eggs are candled, graded, and packed, and much of the poultry is dressed before being moved to eastern markets in full carlots. In some other parts of the Middle West, especially in Minnesota, the local creamery provides a convenient place for assembling and handling eggs. The farmer can deliver his eggs and cream at the same time.

FRUITS AND VEGETABLES

In all of the important commercial growing areas, producers of fruits and vegetables have developed cooperative marketing organizations. More than 1,100 such associations are now operating in 45 States. During the 1937–38 marketing season these associations marketed approximately $300,000,000 worth of products for 164,000 members (Table 8). The greatest development has occurred in production areas farthest from the large eastern markets. California, with 371 associations, through which 37,000 growers marketed $151,000,000 worth of products during the 1937–38 season, leads all other States. Florida, with 85 associations, is the second leading State and is followed by Oregon, Colorado, and Washington (Table 9).

Approximately 60 percent of all the citrus fruit produced in this country is marketed by cooperative organizations. In the California-Arizona area, the proportion marketed cooperatively reaches 85 to 90 percent. Cooperatives have done much to increase the consumption of citrus fruits—oranges, lemons, and to a lesser extent, grapefruit and tangerines—by judicious advertising and by placing on the market a well-graded product.

In the cranberry industry, also, cooperatives have been an important factor in expanding markets by carefully planned advertising and by wise handling of the crop. Fully 60 percent of the cranberry crop is placed on the market by cooperative organizations.

TABLE 8

NUMBER OF FRUIT AND VEGETABLE MARKETING ASSOCIATIONS, ESTIMATED MEMBERSHIP, AND ESTIMATED BUSINESS, 5-YEAR PERIOD 1933–34 TO 1937–38

Marketing Season	Associations (number)	Members * (number)	Volume of Business * (thousand dollars)
1933–34	1,194	185,000	182,000
1934–35	1,082	158,000	200,000
1935–36	1,063	166,000	212,000
1936–37	1,104	144,700	282,000
1937–38	1,164	164,000	300,000

* Estimated.
Source: Compiled from data assembled by the History and Statistics Section, Cooperative Research and Service Division, Farm Credit Administration.

TABLE 9

NUMBER OF FRUIT AND VEGETABLE MARKETING ASSOCIATIONS, ESTIMATED MEMBERSHIP, AND ESTIMATED BUSINESS FOR LEADING STATES, 1937–38 MARKETING SEASON

State	Associations (number)	Membership * (number)	Volume of Business * (thousand dollars)
California......	371	37,000	151,000
Florida........	85	5,400	21,000
Oregon.........	57	9,800	19,000
Colorado.......	32	12,400	15,000
Washington.....	68	9,000	13,500
Michigan.......	54	8,500	9,380
New York......	39	5,800	7,000
All others......	458	76,100	64,120
Total........	1,164	164,000	300,000

* Estimated.
Source: Compiled from data assembled by the History and Statistics Section, Cooperative Research and Service Division, Farm Credit Administration.

Possibly no other vegetable is handled more widely by cooperatives than are potatoes. More than 180 associations scattered over 33 States are now marketing this product. Not all of these are strictly potato associations, as many of them also handle fruits and vegetables of other types. Apples coming mainly from the Pacific Northwest, the Shenandoah Valley, and the commercial areas of Michigan and New York are handled by 78 associations. Strawberries from Louisiana, Missouri, Arkansas, Kentucky, the eastern shore of Virginia, and other commercial areas find their way to market through 125 cooperative associations.

Many other fruits and vegetables are handled in substantial volume by cooperative organizations. Some of the more important of these are included in the list below:

Product	Net Sales by Cooperatives
Citrus	$124,748,000
Potatoes	21,073,000
Grapes *	17,279,000
Apples	11,740,000
Prunes	7,640,000
Strawberries	7,607,000
Cranberries	6,155,000
Peaches	4,632,000
Lima beans	4,092,000
Peas	4,063,000
Pears	3,883,000
Celery	3,146,000
Cherries	2,627,000
Tomatoes	1,933,000
Apricots	1,604,000
Lettuce	1,468,000
Avocados	1,363,000
Olives and olive oil	1,249,000
Asparagus	1,242,000
Beans, green	1,240,000

* Includes table grapes, raisins, grapejuice, and wine.
Source: Data from 1936 nation-wide survey of farmers' cooperatives.

At least 16 other vegetables, 4 other kinds of fruit, and 2 other types of berries are now handled by cooperatives, but in volumes of less than $1,000,000 each.

GRAIN

Starting well back in the 1800's, the cooperative movement among grain-growers had a rather firm foothold in this country before the turn of the century. However, the most active period, as measured by the number of new associations formed, did not occur until 15 to 20 years after 1900. Stimulated by an increasing acreage of wheat and corn during the World War I period, cooperative elevators made their most rapid growth between 1915 and 1921. The peak in number of grain-marketing associations was reached in the early 1920's, when about 4,000 such organizations were operating.

Since that time there has been some decline in the number of associations, but this has not necessarily been accompanied by a corresponding decline in volume of grain handled. As changing conditions have brought better means of transportation, a considerable number of weak local associations have been eliminated, the members and business gravitating to the larger and more efficient organizations.

Nearly all the local elevators handle coal, feed, salt, and other farm supplies. In some instances, particularly in northern Ohio and Indiana, the volume of supplies handled now exceeds the volume of grain marketed, and these associations are more logically classified as purchasing associations, although they still handle considerable quantities of grain for their member-patrons.

For the 1937–38 marketing season, 2,619 grain associations reported an aggregate business of $475,000,000 and a total membership of 360,000 (Table 10).

TABLE 10

NUMBER OF GRAIN * ASSOCIATIONS, ESTIMATED MEMBERSHIP, AND ESTIMATED BUSINESS FOR THE 5-YEAR PERIOD 1933–34 TO 1937–38

Marketing Season	Associations (number)	Members † (number)	Volume of Business † (thousand dollars)
1933–34	3,178	600,000 ‡	285,000
1934–35	3,125	580,000 ‡	315,000
1935–36	3,010	610,000 ‡	360,000
1936–37	2,614	362,000	397,900
1937–38	2,619	360,000	475,000

* Includes dry beans and rice.

† Estimated.

‡ Includes an unknown number of patrons who were not members.

Source: Compiled from data assembled by the History and Statistics Section, Cooperative Research and Service Division, Farm Credit Administration.

The typical local cooperative elevator has a membership of 100 to 200 persons, each of whom owns one or more shares of stock in the organization. Ordinarily dividends on capital are limited to 8 percent or less and voting to one vote per member, regardless of the number of shares owned. Grain is received from both members and nonmembers, and generally the prevailing price is paid at the time of delivery. Supplies likewise are sold at going prices. Any earnings or savings made by the associations are later distributed as patronage dividends on the basis of the volume of business transacted. Some associations distribute patronage dividends to all patrons, and others only to members.

Many of the local elevators hold membership in large regional sales agencies through which much of the grain is marketed.

LIVESTOCK

Meat animals are one of the most important commodities produced on American farms and ranches. Cooperative organizations are playing an important role in the marketing of these animals. . . . Approximately 600,000 producers now hold membership in 900-odd associations engaged in shipping and marketing livestock. During the 1937–38 season the business transacted by these associations exceeded $300,000,000 (Table 11).

TABLE 11

NUMBER OF LIVESTOCK ASSOCIATIONS, ESTIMATED MEMBERSHIP, AND ESTIMATED BUSINESS FOR THE 5-YEAR PERIOD 1933–34 TO 1937–38

Marketing Season	Associations (number)	Members * (number)	Volume of Business * (thousand dollars)
1933–34	1,371	410,000	162,000
1934–35	1,197	410,000	175,000
1935–36	1,040	600,000	250,000
1936–37	1,012	549,000	320,000
1937–38	926	600,000	312,000

* Estimated.
Source: Compiled from data assembled by the History and Statistics Section, Cooperative Research and Service Division, Farm Credit Administration.

Cooperative livestock-marketing associations may be divided roughly into two groups—those operating primarily at terminal markets and those operating primarily in the country. The first group is composed mainly of large terminal sales agencies handling livestock on a commission basis. The latter group is composed chiefly of local associations engaged primarily in assembling and shipping. A few of the local associations do their own selling, but a large majority of them consign the livestock to commission associations at the terminal market.

Dating back to 1883, the local livestock-shipping associations represent a much older movement than does the terminal agency. In many areas local shipping associations were well established when the present terminal agencies first made their appearance. The years 1917–1923 proved to be the period of maximum growth in the local shipping-association movement. At its peak more than 2,300 associations were shipping livestock cooperatively. One of the primary purposes was to assemble livestock in carlots and thus take advantage of carlot transportation.

With the coming of hard-surfaced roads, the movement of livestock by motortruck caused the local shipping associations to become less active and in many cases to cease operations altogether. During recent years direct buying on the part of packers has caused the number of active associations to decline still further. In 1938 approximately 850 were still in operation. Many of these had turned their attention to truck transportation. Some of them own their own trucks and do the hauling themselves. Others function more or less as "bargaining" agencies in arranging with private truckers to haul the livestock under terms and conditions favorable to the livestock producers.

Judging from the increase in the number of members served (Table 11), the decline in number of local shipping associations has not seriously affected the terminal agencies. Many farmers who once shipped through the local associations now are sending their livestock by truck direct to the cooperative commission associations on the terminal market.

Cooperative terminal sales agencies are now operating on practically all of the larger livestock markets in this country as well as on some of the smaller ones. On many of these markets the largest single agency is a farmer-owned organization. Receiving each year from 10 to 15 million head of cattle, calves, hogs, and sheep, the cooperative commission associations handle approximately one-fifth of all livestock sold at public stockyards.

In 1917 the Farmers' Union of Nebraska established the Farmers' Union Livestock Commission on the Omaha Market. This was the first of the present commission associations. From that time on, the movement expanded rather rapidly; in 1925, 28 cooperative commission associations were in operation. By May, 1939, 43 associations with 12 branch agencies were operating on 42 markets and, in addition, 5 regional or State associations were operating at places other than terminal markets. In 1938 these 60 large-scale cooperative agencies handled 12,286,914 head of livestock (Table 12).

TABLE 12

LIVESTOCK HANDLED BY COOPERATIVE SALES AGENCIES, 5-YEAR PERIOD 1934–1938

Year	Agencies * (number)	Livestock Handled (head)
1934	51	13,710,949
1935	55	11,965,517
1936	55	13,846,348
1937	57	13,052,441
1938	60 †	12,286,914 †

* As used here, an agency means a complete operating unit with its own manager, staff of salesmen, and accounting system. Some associations maintain agencies at more than one market.

† Preliminary.

Source: Compiled by the Livestock Section, Cooperative Research and Service Division, Farm Credit Administration.

The commission associations at the terminal markets receive the consigned livestock and take care of the yarding, feeding, watering, sorting, and selling. In addition to handling livestock for sale, they also purchase stockers and feeders for their member-patrons.

WOOL

Approximately 50,000 ranchers and farmers scattered throughout the United States are marketing wool cooperatively. During the 1937–38 season this group of wool growers sold $11,300,000 worth of wool through 130 cooperative organizations (Table 13). The greater part of the wool marketed cooperatively is handled by 25 or 30 large-scale centralized associations, which operate on a State-wide or regional basis. These cooperatives assemble, grade, warehouse, and sell the wool for their member-patrons. Much of the wool handled by this group of associations is marketed through the National Wool Marketing Corporation in Boston.

TABLE 13

NUMBER OF WOOL AND MOHAIR ASSOCIATIONS, ESTIMATED MEMBERSHIP, AND ESTIMATED BUSINESS FOR THE 5-YEAR PERIOD 1933–34 TO 1937–38

Marketing Season	Associations (number)	Members * (number)	Volume of Business * (thousand dollars)
1933–34	120	63,800	13,700
1934–35	119	71,000	15,700
1935–36	114	51,400	11,000
1936–37	139	79,200	11,500
1937–38	130	50,000	11,300

* Estimated.

Source: Compiled from data assembled by the History and Statistics Section, Cooperative Research and Service Division, Farm Credit Administration.

The remainder of the associations are mostly local wool pools. Generally, these organizations are small and often serve but a single county. In most cases they are informally organized and are frequently inactive except for a month or two after shearing time. The wool is assembled and offered for sale to the highest bidder, consigned to another cooperative or a private sales agency, or sold direct to mills.

COTTON

Cooperation among cotton farmers has developed along three distinct lines: (1) cotton marketing associations, (2) cotton gins . . . and (3) cottonseed-oil mills.

Located at strategic points throughout the Cotton Belt are 15 large-scale centralized marketing associations, most of which are operating on a State-wide or regional basis. These associations report a total aggregate membership of 280,000 cotton farmers, and during the crop year of 1938–39 they handled 1,522,037 bales of cotton. Approximately half of this was Government-loan cotton. During the 5 years ended in 1939 the proportion of the total cotton crop handled by the marketing associations ranged from 12.2 percent to 17.5 percent (Table 14). Only once during the last 15 years has the aggregate annual volume dropped below the 1,000,000-bale level. Three times during that period it has exceeded 2,000,000 bales.

TABLE 14

COTTON HANDLED BY LARGE-SCALE COOPERATIVE COTTON-MARKETING ASSOCIATIONS, 6-YEAR PERIOD 1933–34 TO 1938–39

Marketing Season	Associations (number)	Cooperative Deliveries			Total Ginnings Handled Cooperatively † (percent)
		Bales for Sale (number)	Bales for Government Loan * (number)	Total Bales Handled (number)	
1933–34	15	1,104,975	651,111	1,756,086	13.9
1934–35	15	847,397	811,193	1,658,590	17.5
1935–36	15	1,456,238	59,365	1,515,603	14.5
1936–37	15	1,863,629	....	1,863,629	15.3
1937–38	15	1,541,355	691,091	2,232,446	12.2
1938–39	15	723,005	799,032	1,522,037	13.1

* This service consisted mainly of classing and filling out loan documents.

† Running bales as reported by the U.S. Bureau of the Census.

Source: Compiled from data assembled by the Cooperative Research and Service Division, Farm Credit Administration.

The cotton-gin movement has reached its greatest development in Texas and Oklahoma, where 20 to 25 percent of the crop is ginned through farmer-owned and farmer-operated plants. In these two States alone more than 400 cooperative gins have been organized within the last 20 years, fully half of them within the last 5-year period. At present there are more than 70 gin associations in Mississippi, nearly all of which are less than 5 years old.

The movement is gradually spreading to other cotton States and at least a few such organizations are now to be found in New Mexico, Arizona, California, Louisiana, Alabama, and several other Southern States. In some regions where ginning charges were high, opportunities for savings have been great. Some of the earlier cooperative gins were able to pay for their plants out of savings within a relatively short period.

In addition to ginning seed cotton and supplying the bagging and ties necessary for wrapping the bales, the cooperative gin ordinarily markets the cottonseed for its members. In some instances these organizations also market a part of the cotton lint.

Ordinarily cottonseed is sold by the cooperative gins to private oil mills, but during recent years cotton growers in certain areas have undertaken to extend their cooperative activities into the crushing field. At the present time there are 6 cooperative oil mills in operation. Oldest of these is at Minter City, Miss. This association was organized in 1922 and has operated continuously since that date. Of the other 5, 2 were organized in 1934, 2 in 1937, and 1 in 1939. During the 1937–38 season the 5 associations then operating crushed a total of 107,900 tons of seed at an estimated saving of more than $350,000 for the member-growers.

All told, 415 cotton associations were in operation during the 1937–38 marketing season (Table 15). As indicated previously, 15 of these were large-scale selling agencies, 5 were oil mills, and the remainder were cooperative gins. During the year the aggregate sales of these 415 associations amounted to $110,000,000.

TABLE 15

NUMBER OF COTTON ASSOCIATIONS, ESTIMATED MEMBERSHIP AND ESTIMATED BUSINESS, 5-YEAR PERIOD 1933–34 TO 1937–38

Marketing Season	Associations (number)	Members * (number)	Volume of Business † (thousand dollars)
1933–34	250	200,000	100,000
1934–35	305	255,000	100,000
1935–36	311	300,000	110,000
1936–37	401	341,800	138,500
1937–38	415	350,000	110,000

* Estimated.

† Includes some Government-loan cotton.

Source: Compiled from data assembled by the History and Statistics Section, Cooperative Research and Service Division, Farm Credit Administration.

Probably no other phase of cooperation in the South is making greater gains at the present time than is the gin movement. The number of "co-op" gins has increased since the close of the 1937–38 season, and well-informed persons have stated that the number now exceeds 500.

OTHER PRODUCTS HANDLED COOPERATIVELY

More than 15,000 farmers, located mainly in California, Oregon, Georgia, and Virginia, are marketing nuts cooperatively. During the 1937–38 season, 52 active nut associations reported an aggregate business of $15,800,000.

Eleven associations, having a combined membership of 70,000, are marketing tobacco. Marketing hay is the principal enterprise of 8 associations and a secondary enterprise of at least 40 others. There are 25 to 30 sugar-beet bargaining associations. In the Southern States 8 or 10 cooperatives are manufacturing cane sugar. And one or more associations are handling each of the following products: maple sirup and maple sugar, honey, timber, nursery stock, pulpwood, tung oil, broomcorn, and fox fur.

SELECTED DATA ON AGRICULTURAL MARKETING

Exhibit 1. Farm-to-Retail Price Spreads and Marketing Charges for Farm Food Products, 1913–1945
Exhibit 2. Farm-to-Retail Price Spreads and Marketing Charges, by Major Food Commodity Groups, Averages 1921–1930 and 1935–1939, Annual 1940–1945
Exhibit 3. Farm Income—Estimated Cash Receipts by Commodities, 1940–1945
Exhibit 4. Farmers' Cooperative Marketing and Purchasing Associations: Number, Estimated Membership, and Estimated Business, by Commodity Groups, 1940–1944
Exhibit 5. Farmer Cooperatives in 1944: Number, Estimated Membership, and Estimated Business, by Geographic Division, State, and Commodity

EXHIBIT 1

FARM-TO-RETAIL PRICE SPREADS AND MARKETING CHARGES FOR FARM FOOD PRODUCTS, 1913–1945 [a]

Year	Retail Cost [b] (dollars)	Farm Value [c] (dollars)	Marketing Margin [d] (dollars)	Government Marketing Taxes (−) and Payments (+) [e] (dollars)	Marketing Charges [f] (dollars)	Farmer's Share of Consumer's Dollar [g] (cents)
1913	264	124	140	0	140	47
1914	272	125	147	0	147	46
1915	267	120	147	0	147	45
1916	321	145	176	0	176	45
1917	442	210	232	0	232	48
1918	458	235	223	0	223	51
1919	513	250	263	0	263	49
1920	568	245	323	0	323	43
1921	427	172	255	0	255	40
1922	408	163	245	0	245	40
1923	413	166	247	0	247	40
1924	406	166	240	0	240	41
1925	442	191	251	0	251	43
1926	448	188	260	0	260	42
1927	434	180	254	0	254	41
1928	435	186	249	0	249	43
1929	435	183	252	0	252	42
1930	421	165	256	0	256	39
1931	339	121	218	0	218	36
1932	284	92	192	0	192	32
1933	276	90	186	−2	184	33
1934	311	107	204	−9	195	34
1935	347	138	209	−9	200	40
1936	349	143	206	0	206	41
1937	362	156	206	0	206	43
1938	328	128	200	0	200	39
1939	316	122	194	0	194	39
1935–1939 average	340	137	203	−2	201	40
1940	317	128	189	0	189	40
1941	347	154	193	0	193	44
1942	407	196	211	0	211	48
1943	458	236	222	+5	227	52
1944	451	237	214	+12	226	53
1945	459	247	212	+16	228	54

[a] These estimates are calculated in terms of a market basket of farm food products, containing quantities equivalent to 1935–1939 annual average purchases per family of three average consumers. The market basket total is broken down into six major commodity groups, as shown in the succeeding table. Quantities of foods valued in these series do not change from year to year.

[b] Retail costs of the market basket and commodity groups are calculated from prices estimated to represent average cost to all purchasing consumers in the United States. These are based principally upon retail price series published by the Bureau of Labor Statistics and the Bureau of Agricultural Economics, with supplementary adjustments.

[c] Farm value is calculated from official series showing prices received by farmers applied to quantities of farm products equivalent to retail purchases and is adjusted by subtracting an imputed value at the farm level of nonfood byproducts obtained in processing. No adjustment is made for various Government payments to producers.

[d] The marketing margin is the spread or difference between retail cost to consumers and payments to farmers for equivalent produce, less imputed value of byproducts.

[e] For the quantities of products included in the market basket, total Government taxes levied upon processors and other marketing agencies are denoted by a minus sign, while total payments to marketing agencies are denoted by a plus sign.

[f] Marketing charges equal the marketing margin, minus Government marketing taxes, plus Government marketing payments, and represent total payments to marketing agencies for their services.

[g] The farmer's share of the consumer's dollar spent for farm food products is obtained by expressing the farm value as a percentage of retail cost. The remainder of the consumer's dollar goes to pay the marketing margin and does not include Government payments to marketing agencies but does include Government taxes on these agencies.

Source: U.S. Department of Agriculture, *Agricultural Statistics, 1946* (Washington, D.C., U.S. Government Printing Office, 1946), Table 628, p. 576.

EXHIBIT 2

FARM-TO-RETAIL PRICE SPREADS AND MARKETING CHARGES, BY MAJOR FOOD COMMODITY GROUPS, AVERAGES 1921–1930 AND 1935–1939, ANNUAL 1940–1945 [a]

Commodity Group and Year	Retail Cost [b] (dollars)	Net Farm Value Adjusted for By-products [c] (dollars)	Margin Adjusted for By-products [d] (dollars)	Government Marketing Taxes (−) [e] (dollars)	Government Marketing Payments (+) [e] (dollars)	Marketing Charges (adjusted margin) [f] (dollars)	Farmer's Share [g] (percent)
Meat products:							
1921–1930 average	98.90	50.83	48.07	....	....	48.07	51
1935–1939 average	88.09	46.35	41.74	−1.09	....	40.65	53
1940	76.67	40.40	36.27	....	....	36.27	53
1941	88.14	52.60	35.54	....	....	35.54	60
1942	103.04	69.32	33.72	...	....	33.72	67
1943	106.88	75.34	31.54	....	+3.61	35.15	70
1944	101.47	73.98	27.49	....	+6.42	33.91	74
1945	100.31	76.59	23.72	....	+9.47	33.19	76
Dairy products:							
1921–1930 average	82.97	42.66	40.31	....	....	40.31	51
1935–1939 average	67.27	33.47	33.80	....	....	33.80	50
1940	68.02	33.49	34.53	....	....	34.53	49
1941	74.07	37.93	36.14	....	....	36.14	51
1942	82.44	43.70	38.74	....	....	38.74	53
1943	88.93	50.62	38.31	....	+1.61	39.92	57
1944	88.34	51.83	36.51	....	+2.61	39.12	59
1945	88.76	52.00	36.76	....	+2.30	39.06	59
Poultry and eggs:							
1921–1930 average	37.00	24.76	12.24	....	....	12.24	67
1935–1939 average	26.47	17.56	8.91	....	....	8.91	66
1940	24.36	15.47	8.89	....	....	8.89	64
1941	28.48	19.51	8.97	....	....	8.97	69
1942	35.21	24.25	10.96	....	....	10.96	69
1943	41.77	30.58	11.19	....	....	11.19	73
1944	40.84	28.21	12.63	....	....	12.63	69
1945	43.25	31.64	11.61	....	....	11.61	73
Bakery and other cereal products:							
1921–1930 average	63.13	15.31	47.82	−0.01	....	47.81	24
1935–1939 average	55.09	11.39	43.70	−0.66	....	43.04	21
1940	51.39	9.75	41.64	−0.05	....	41.59	19
1941	52.55	11.51	41.04	−0.05	....	40.99	22
1942	57.80	14.21	43.59	−0.05	+0.02	43.56	25
1943	61.77	17.55	44.22	−0.05	+0.20	44.37	28
1944	63.62	19.15	44.47	−0.05	+1.89	46.31	30
1945	63.89	19.86	44.03	−0.05	+2.77	46.75	31
Fruits and vegetables, fresh and processed:							
1921–1930 average	112.60	36.13	76.47	....	....	76.47	32
1935–1939 average	77.58	23.91	53.67	....	....	53.67	31
1940	72.89	24.78	48.11	....	....	48.11	34
1941	77.94	27.60	50.34	....	....	50.34	35
1942	97.02	36.83	60.19	....	....	60.19	38
1943	126.24	54.27	71.97	....	+0.24	72.21	43
1944	123.90	55.34	68.56	....	+1.09	69.65	45
1945	130.65	57.96	72.69	....	+1.31	74.00	44
Miscellaneous food products:							
1921–1930 average	32.24	6.25	25.99	−0.06	....	25.93	19
1935–1939 average	25.97	4.77	21.20	−0.24	....	20.96	18
1940	23.96	3.84	20.11	−0.33	....	19.78	16
1941	25.96	5.14	20.82	−0.33	....	20.49	20
1942	31.80	7.54	24.26	−0.32	+0.05	23.99	24
1943	32.62	8.14	24.48	−0.32	+0.16	24.32	25
1944	32.38	8.91	23.47	−0.33	+0.46	23.60	28
1945	32.19	9.30	22.89	−0.33	+0.67	23.23	29

Notes for Exhibit 2 on following page.

NOTES FOR EXHIBIT 2

[a] These estimates are calculated in terms of a market basket of farm food products, containing quantities equivalent to 1935–1939 annual average purchases per family of three average consumers. The market basket total is broken down into six major commodity groups, as shown in the succeeding table. Quantities of foods valued in these series do not change from year to year.

[b] Retail costs of the market basket and commodity groups are calculated from prices estimated to represent average cost to all purchasing consumers in the United States. These are based principally upon retail price series published by the Bureau of Labor Statistics and the Bureau of Agricultural Economics, with supplementary adjustments.

[c] Farm value is calculated from official series showing prices received by farmers applied to quantities of farm products equivalent to retail purchases and is adjusted by subtracting an imputed value at the farm level of nonfood byproducts obtained in processing. No adjustment is made for various Government payments to producers.

[d] The marketing margin is the spread or difference between retail cost to consumers and payments to farmers for equivalent produce, less imputed value of byproducts.

[e] For the quantities of products included in the market basket, total Government taxes levied upon processors and other marketing agencies are denoted by a minus sign, while total payments to marketing agencies are denoted by a plus sign.

[f] Marketing charges equal the marketing margin, minus Government marketing taxes, plus Government marketing payments, and represent total payments to marketing agencies for their services.

[g] The farmer's share of the consumer's dollar spent for farm food products is obtained by expressing the farm value as a percentage of retail cost. The remainder of the consumer's dollar goes to pay the marketing margin and does not include Government payments to marketing agencies but does include Government taxes on these agencies.

Source: U.S. Department of Agriculture, *Agricultural Statistics, 1946* (Washington, D.C., U.S. Government Printing Office, 1946), Table 629, p. 577.

EXHIBIT 3

FARM INCOME—ESTIMATED CASH RECEIPTS BY COMMODITIES, 1940–1945 (000 omitted)

	1940	1941	1942	1943	1944	1945
Crops—total	$3,470	$4,718	$6,329	$ 7,982	$ 9,039	$ 9,056
Cotton and cottonseed	647	1,046	1,237	1,314	1,497	1,034
Tobacco	241	323	474	541	689	954
Bread grains *	479	756	942	961	1,328	1,313
Oil bearing crops †	127	232	433	654	591	579
Feeds, grains, and hay	572	594	799	1,122	1,194	1,370
Vegetables	591	730	1,087	1,579	1,567	1,642
Fruits and tree nuts	442	613	826	1,222	1,501	1,449
Sugar crops	79	92	128	108	133	168
Other crops ‡	292	332	403	481	539	547
Livestock and products—total	$4,873	$6,439	$8,987	$11,360	$11,199	$11,725
Hogs	836	1,301	2,191	2,942	2,813	2,288
Cattle and calves	1,381	1,718	2,293	2,581	2,604	3,219
Sheep and lambs	180	227	307	342	303	319
Wool	106	139	157	160	147	135
Dairy products	1,516	1,897	2,336	2,809	2,949	3,070
Poultry and eggs	810	1,107	1,652	2,447	2,306	2,597
Other §	44	49	51	79	76	97

* Wheat, rye, rice, buckwheat.

† Flaxseed, soybeans, peanuts.

‡ Includes greenhouse and nursery products, legumes and grass seeds, hemp, hops, peppermint, popcorn, and forest products.

§ Includes mohair, mules, and honey.

Source: U.S. Department of Agriculture, *Net Farm Income and Parity Report, 1943;* thereafter *The Farm Income Situation* series. Adapted from U.S. Bureau of the Census, *Statistical Abstract of the United States, 1946* (Washington, D.C., U.S. Government Printing Office, 1946), Tables 694, 695, pp. 625, 626.

EXHIBIT 4

FARMERS' COOPERATIVE MARKETING AND PURCHASING ASSOCIATIONS: NUMBER, ESTIMATED MEMBERSHIP, AND ESTIMATED BUSINESS, BY COMMODITY GROUPS, 1940–1944[a]

Associations Listed[b]

Commodity Group	1940 (number)	1941 (number)	1942 (number)	1943 (number)	1944 (number)
Marketing:					
Cotton and cotton products[c]	535	556	539	533	530
Dairy products	2,374	2,366	2,369	2,286	2,214
Fruits and vegetables	1,048	945	944	920	916
Grain (including dry beans and rice)	2,422	2,389	2,358	2,311	2,285
Livestock	800	781	700	642	661
Nuts	48	46	46	48	46
Poultry and products	179	178	166	159	160
Tobacco	10	11	11	11	12
Wool and mohair	136	128	134	135	130
Miscellaneous products[d]	391	424	441	477	446
Total marketing	7,943	7,824	7,708	7,522	7,400
Purchasing	2,657	2,726	2,742	2,778	2,750
Total marketing and purchasing	10,600	10,550	10,450	10,300	10,150

Estimated Membership[e]

Marketing:					
Cotton and cotton products[c]	225,000	215,000	235,000	258,000	266,000
Dairy products	650,000	665,000	710,000	702,000	726,000
Fruits and vegetables	157,000	153,000	160,000	160,000	162,000
Grain (including dry beans and rice)	363,000	380,000	400,000	452,000	484,000
Livestock	600,000	570,000	600,000	636,000	695,000
Nuts	42,000	44,000	53,000	49,000	46,700
Poultry and products	105,000	115,000	111,000	130,000	130,600
Tobacco	104,000	114,500	124,300	120,000	122,000
Wool and mohair	74,000	76,000	85,000	107,000	122,500
Miscellaneous products[d]	100,000	97,500	101,700	115,000	140,200
Total marketing	2,420,000	2,430,000	2,580,000	2,730,000	2,895,000
Purchasing	980,000	1,170,000	1,270,000	1,660,000	1,610,000
Total marketing and purchasing	3,400,000	3,600,000	3,850,000	4,390,000	4,505,000

Estimated Business[f][g]
(000 omitted)

Marketing:					
Cotton and cotton products[c]	$ 85,000[h]	$ 138,000[h]	$ 167,000[h]	$ 189,000[h]	$ 178,000
Dairy products	693,000	815,000	950,000	1,203,000	1,294,000
Fruits and vegetables	274,000	325,000	450,000	638,000	784,000
Grain (including dry beans and rice)	387,000	524,000	700,000	1,178,000	1,286,000
Livestock	292,000	337,000	595,000	747,000	730,000
Nuts	31,000	39,300	75,000	159,000	200,000
Poultry and products	82,000	105,000	145,000	196,000	225,000
Tobacco	14,400	15,200	17,700	18,600	27,000
Wool and mohair	17,000	23,300	34,000	39,000	35,000
Miscellaneous products[d]	35,600	38,200	46,300	62,400	76,000
Total marketing	$1,911,000	$2,360,000	$3,180,000	$4,430,000	$4,835,000
Purchasing	369,000[i]	480,000[i]	600,000[i]	730,000[i]	810,000
Total marketing and purchasing	$2,280,000	$2,840,000	$3,780,000	$5,160,000	$5,645,000

Notes for Exhibit 4 on following page.

NOTES FOR EXHIBIT 4

[a] Reports of associations are included for both the calendar year and for fiscal periods beginning within the calendar year shown.

[b] Includes independent local associations, federations, large-scale centralized associations, sales agencies, and independent service-rendering associations.

[c] Includes ginned cotton, cottonseed, cottonseed oil, cottonseed meal, etc.

[d] Includes associations handling commodities not specified above, those handling several types of commodities, and those furnishing special services.

[e] Includes members, contract members, and shareholders, but does not include patrons not in these categories.

[f] Includes some intra-association business.

[g] Includes the value of commodities sold or purchased for patrons and the service charges for associations rendering other essential services either in marketing or purchasing.

[h] Includes some Government loan cotton.

[i] After adjustments for purchasing business by the marketing associations and marketing business by the purchasing associations, the totals for purchasing business are: 1940, in excess of $450,000,000; 1941, approximately $600,000,000; 1942, approximately $750,000,000; 1943, approximately $1,010,000,000; 1944, approximately $1,095,000,000.

Source: U.S. Department of Agriculture, *Agricultural Statistics, 1946* (Washington, D.C., U.S. Government Printing Office, 1946), Table 704, p. 654. Figures supplied by Farm Credit Administration. Data for seasons prior to 1940 appear in the *Yearbook* and in earlier issues of *Agricultural Statistics*.

EXHIBIT 5

FARMER COOPERATIVES IN 1944

10,300 Associations Do a $5,160,000,000 Purchasing and Marketing Business

These figures are compiled by the Cooperative Research and Service Division of the Farm Credit Administration, and represent the only annual survey of farmer cooperatives in the United States. Included are independent local associations, federations, large-scale centralized associations, sales agencies, independent service-rendering associations, and subsidiaries whose businesses are distinct from the parent organization. Membership figures include members, contract members, and shareholders, but do not include patrons not in these categories. Membership and business are credited to the divisions and states in which the associations have their headquarters. Estimated business includes some intra-association transactions.

Geographic Division, State, Group	Associations Listed		Estimated Membership		Estimated Business	
	Number	Percent	Number	Percent	$1,000	Percent
Geographic division:						
West North Central	4,142	40.2	1,348,630	30.7	1,531,040	29.7
East North Central	2,451	23.8	1,116,170	25.4	1,165,070	22.6
Pacific	828	8.0	244,270	5.6	798,420	15.5
Middle Atlantic	604	5.9	399,500	9.1	441,790	8.6
South Atlantic	477	4.6	401,400	9.1	378,440	7.3
West South Central	795	7.7	261,850	6.0	291,500	5.6
Mountain	569	5.5	211,350	4.8	249,910	4.8
New England	161	1.6	139,840	3.2	174,800	3.4
East South Central	273	2.7	266,990	6.1	129,030	2.5
Total	10,300	100.0	4,390,000	100.0	5,160,000	100.0
State:						
California	464	4.5	96,700	2.2	526,620	10.2
Minnesota	1,364	13.3	391,800	8.9	493,000	9.5
Illinois	611	5.9	374,720	8.5	369,590	7.2
New York	367	3.6	272,170	6.2	290,060	5.6
Iowa	744	7.2	317,770	7.2	284,000	5.5
Wisconsin	1,065	10.3	249,700	5.7	257,340	5.0
Ohio	305	3.0	187,300	4.3	219,640	4.3
Missouri	322	3.1	210,940	4.8	196,680	3.8
Texas	487	4.7	145,700	3.3	176,200	3.4
Indiana	195	1.9	177,600	4.1	174,470	3.4
All others	4,376	42.5	1,965,600	44.8	2,172,400	42.1
Total	10,300	100.0	4,390,000	100.0	5,160,000	100.0
Marketing:						
Cotton and products	533	5.2	258,000	5.9	189,000	3.7
Dairy products	2,286	22.2	702,000	16.0	1,203,000	23.3
Fruits and vegetables	920	8.9	160,200	3.7	638,000	12.4
Grain, dry beans, rice	2,311	22.4	452,000	10.3	1,178,000	22.8
Livestock	642	6.2	636,000	14.5	747,000	14.5
Nuts	48	0.5	49,000	1.1	159,000	3.1
Poultry and eggs	159	1.6	130,000	3.0	196,000	3.8
Tobacco	11	0.1	120,000	2.7	18,600	0.4
Wool and mohair	135	1.3	107,000	2.4	39,000	0.7
Miscellaneous *	477	4.6	115,800	2.6	62,400	1.2
Total marketing	7,522	73.0	2,730,000	62.2	4,430,000	85.9
Purchasing	2,778	27.0	1,660,000	37.8	730,000 †	14.1
Total marketing and purchasing	10,300	100.0	4,390,000	100.0	5,160,000	100.0

* Includes associations handling commodities not specified above, those handling several types of commodities, and those furnishing special marketing or other services.

† After making adjustments for the purchasing business of marketing associations and the marketing business of the purchasing associations it is estimated that the total purchasing business was approximately $1,010,000,000, 19.6 percent of total farmer cooperative business.

Source: National Council of Farmer Cooperatives, *1945 Blue Book* (Washington, D.C., U.S. Government Printing Office, 1945), p. 19.

VI. BRAND POLICY

BRAND AND PRICE POLICIES OF LARGE-SCALE DISTRIBUTORS

BY NEIL H. BORDEN

EVIDENCE REGARDING PRICING POLICIES OF LARGE-SCALE DISTRIBUTORS

In addition to specific price and margin data, . . . general statements as to the policy followed by distributors in pricing their brands, as their prices relate not only to those of manufacturers' brands but also to those of other distributors' brands, were obtained from the organizations interviewed in the survey. Such generalized statements are, of course, not highly satisfactory evidence, but they serve to show the general attitudes of the managements toward competitive prices.

POLICY OF PRICING PRIVATE BRANDS RELATIVE TO MANUFACTURERS' ADVERTISED BRANDS

As shown in Table 128, 48 out of the 61 organizations stated that their policy was to set the prices on their own brands below those of equivalent manufacturers' advertised brands; 12 stated that they set them at the same level as manufacturers' brands. Thus in most instances the chains offered a price inducement to get sales, relying in addition upon point-of-purchase promotion, customer friendship, limited advertising, and satisfaction from use, to develop patronage.

While offering lower prices, they normally took much more liberal markups on their own brands than they did on comparable manufacturers' brands. Fifty-seven out of 61 organizations stated that generally they received a higher markup on their own brands (Table 129). Large markup was acknowledged as one of the great inducements to selling under their own brands.

The evidence gathered indicates that in pricing their own brands, the chains and other large-scale distributors have been influenced primarily by two considerations: the prices of the leading manufacturers' brands and the desire for a satisfactory margin. They have had in mind price savings which, added to the point-of-purchase promotion and selling employed, would gradually overcome the preferences enjoyed by manufacturers' brands. Often they have deemed it wise, particularly in the early stages of marketing private brand items, when

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Source: Excerpts from *The Economic Effects of Advertising* (Chicago, Irwin, 1942), Chap. XXI, pp. 589–602, Chap. XXII, pp. 631–639. Reprinted by permission.

TABLE 128

REPLIES OF LARGE-SCALE DISTRIBUTORS REGARDING PRACTICES GENERALLY FOLLOWED IN PRICING EQUIVALENT MERCHANDISE SOLD UNDER THEIR OWN BRANDS, AS RELATED TO PRICES OF LEADING MANUFACTURERS' BRANDS, 1939

Number and Type of Organizations Reporting	Policy Generally Was to Price Merchandise under Own Labels		
	Above Prevailing Prices of Leading Manufacturers' Brands	At Same Level as Prices of Leading Manufacturers' Brands	Below Prevailing Prices of Leading Manufacturers' Brands
20 corporate food chains	..	4	16
13 corporate drug chains	..	2	11
11 voluntary food chains wholesaler members *	..	4	6
7 voluntary food chains headquarters	..	2	5
5 limited price variety chains *	..	..	5
5 dry goods or department store chains †	..	..	5
Total replies	0	12	48

* One organization stated that it priced its own brands in most instances on a cost plus desired markup basis.

† Two organizations stated that they priced their own brands in most instances on a cost plus markup basis. The resulting price was usually below manufacturers'.

TABLE 129

REPLIES OF LARGE-SCALE DISTRIBUTORS REGARDING RELATIONSHIP IN GENERAL BETWEEN GROSS MARGIN RECEIVED ON ARTICLES SOLD UNDER OWN BRANDS COMPARABLE WITH THOSE SOLD UNDER MANUFACTURERS' BRANDS, 1939

Number and Type of Organization Reporting	Generally Speaking, Gross Margins on Own Brands as Related to Gross Margins on Comparable Manufacturers' Brands Were:		
	Higher	About the Same	Lower
20 corporate food chains	19	1	
13 corporate drug chains	12	1	
11 voluntary food chains, wholesaler members	10	1	
7 voluntary food chains, headquarters	7		
5 limited price variety chains	4	1	
5 dry goods and department store chains	5		
Total replies	57	4	0

they have been developing a following for these items, not to place their prices too far below those of the well-known brands, because they had found that to do so might lead consumers to question the quality of their items. In some instances, however, in the initial stages private branders have priced their brands on certain items at wide differentials below the advertised manufacturers' brands. The following instances were cited: When advertised brands of cake flour were generally retailing for 25 cents a package, one chain brought out a private brand for 17 cents and another chain launched its brand at 13 cents. When a leading dessert was retailing for 10 cents a package, a large chain brought out a competing item for 5 cents. From the data it is evident that the initial pricing of private brands in relation to the prices of advertised manufacturers' brands varies widely and follows no single pattern. It is clear, however, that when private branders have set their prices at a differential which will give needed volume, they ordinarily have received relatively large gross margins. They have desired to take better margins on their private brands than on manufacturers' brands, in part, because they have recognized a somewhat higher cost for selling their own brands; in part, because they have felt that such margins have been necessary to show a satisfactory profit on their total operations. They have felt that on well-known manufacturers' brands they have had to stand the brunt of fierce price competition among retailers, with resultant margins often becoming too narrow to satisfy them. A number of those interviewed pointed out that when the retailer feels forced, because of customers' demand, to sell certain types of merchandise at margins which do not cover his full cost of operations plus a profit, he must seek to increase his margin on other types of merchandise in order to show an over-all profit or even to continue in business; hence his desire for good margins. Generally distributors have cut the margins on their own brands as low as those received on manufacturers' brands only when forced to do so to get sales.

While the evidence of the survey showed a tendency for distributors frequently to price with reference to manufacturers' prices, such was not always the case. On numerous items they reported taking a normal gross margin, even though the prices of manufacturers' brands might have permitted them to take more. Some organizations followed this practice more than others. In February, 1941, two years after the survey was made, an executive of a large chain stated that his organization had in recent years tended to change its pricing methods on its own brands. Instead of pricing them with reference to manufacturers' brands, it more frequently followed the practice of applying a desired markup on cost of merchandise. As a result, for numerous items the spread between manufacturers' brands and their own brands had widened. He expressed the opinion that this practice was being adopted by other chains. Time did not permit further inquiry to see whether this practice was becoming general among chains.

Pricing Policy As Related to Competing Distributors' Brands

In spite of the fact that distributors generally set the prices on their own brands with reference to competing manufacturers' brands, there was evidence of a substantial price competition between distributors' brands. This competition has generally come in the stage after distributors' brands have become well known in the market and have become acceptable to a considerable group of consumers. Then low price has been an effective means of attracting volume. Case material indicated that numerous large-scale retailers have used their own brands in recent years as leaders to attract trade. The fact that some chains, mail-order houses, and department stores have made an appeal for patronage on the basis of not being undersold has led them to give close attention to competitors' prices of private brands as well as manufacturers' brands. Upon manufacturers' brands, competitive prices clearly have had to be met if these stores were to maintain their reputations. When these stores have competed with private brands, such exact comparisons of price have been avoidable because the merchandise of the two suppliers has not been identical. Nevertheless, these organizations have recognized the danger of permitting prices of their own brands to be much higher than those of other retailers. In the survey it was found that all the distributors recognized the need of keeping their private brand prices in line with those of competitors unless superiority of merchandise, or store service, or location permitted them to set higher prices.

TABLE 130

REPLIES OF LARGE-SCALE DISTRIBUTORS REGARDING PRACTICES GENERALLY FOLLOWED IN PRICING MERCHANDISE SOLD UNDER THEIR OWN BRANDS AS RELATED TO COMPARABLE MERCHANDISE SOLD UNDER COMPETING RETAILERS' BRANDS

Number and Type of Organizations Reporting	Policy Generally Was to Price Merchandise under Own Label:		
	Above Prices of Comparable Competing Retailers' Brands	At Same Level as Prices of Comparable Competing Retailers' Brands	Below Prices of Comparable Competing Retailers' Brands
20 corporate food chains	2	18	
13 corporate drug chains	2	9	1
11 voluntary food chains, wholesaler members *	..	10	
7 voluntary food chains, headquarters †	..	6	
5 limited price variety chains *	..	4	
5 dry goods or department store chains ‡	..	3	
Total replies	4	50	1

* One organization stated that it priced its own brands in most instances on a cost plus markup basis.

† One organization stated that it did not pay much attention to prices of competing distributors' brands.

‡ Two organizations stated that they priced their own brands in most instances on a cost plus markup basis.

Evidence of this is found in the fact that 50 out of 61 organizations covered in the survey stated that they sought to price their brands at the same levels as those adopted for competing retailers' brands of comparable quality (Table 130). One corporate chain sought to price its brands under competitors' brands; four placed their prices above those of competitors.

Although the statistical evidence showing the extent of price competition among distributors' brands is not conclusive, observation as well as the evidence given leads to the belief that direct competition among distributors' brands, particularly among chains, has tended in time to turn upon price rather than upon extensive use of advertising and promotion, although there has been some of the latter. That they have not turned to advertising competition in large volume is indicated by the fact that there has been little evidence of growth in advertising costs of such organizations, but inspection of advertisements indicates that some chains give a relatively larger amount of space to their own brands and less to manufacturers' brands than was true some years ago.

In so far as competition on price has tended to drive down prices on distributors' brands, manufacturers' brands in turn have been affected. When a private brand item reaches a stage at which it is well known in its market and is acceptable to many consumers, it will be taken in large volume if it is offered at an attractive price. When this stage is reached, manufacturers must take care to see that they do not permit the differential between their brands and such distributors' brands to become too wide, because the evidence not only of this survey but of case material has indicated that whenever too much of a price differential has been sought by an advertiser for his product, sales have tended to shift to lower-price merchandise.

CONSIDERATIONS DETERMINING ENTRANCE OF DISTRIBUTORS' BRANDS

Distributors with private brands do not attempt to establish their brands on all products they sell. This fact is illustrated by the responses of grocery concerns which were asked in the survey to indicate whether they sold certain selected items under their own brands. The answers from 20 corporate food chains, 9 wholesaler members of voluntary food chains, and 7 headquarters officers of voluntary food chains are shown in Table 131. Coffee, canned vegetables, salad dressing, flour, canned fruit, and canned milk were mentioned by over 30 of the 36 organizations replying. On the other hand, products such as baking soda, soaps of all kinds, kitchen cleansers, and canned soups were among items mentioned by less than half the organizations.

The considerations determining whether retailers will seek to sell specific products under their own brands are many and vary not only for different products, but also among concerns. A few of the conditions which are especially pertinent in this study are brought out by the evidence of the survey and by case material.

In the survey the concerns were asked to state why they did not handle certain specific items, and the reasons they gave indicate conditions which govern their entry into the private branding of various items. For example, only 2 out of the 20 corporate food chains supplying data stated that they carried a tomato soup to compete with the Campbell brand. The reasons specified for not carrying the product under their own brand were the following: ten stated that the advertised brands were too strongly entrenched to permit the development of satisfactory volume; one organization stated that it had not been able to find a suitable supply for such a product; three stated that they were satisfied with the margin obtained on advertised brands; three stated that the margin to be obtained on their own brand was not sufficient to make it worth while; and another three stated that the expense of promoting their own brands to secure the needed demand would be too heavy. Another consideration which was mentioned was the difficulty of getting sufficient volume of sales in early stages to support good purchasing contracts or to permit obtaining desired turnover on stocks specified in purchasing contracts.

TABLE 131

NUMBER OF ORGANIZATIONS SELLING CERTAIN SPECIFIED ARTICLES UNDER THEIR OWN BRANDS AMONG TWENTY CORPORATE FOOD CHAINS AND SIXTEEN VOLUNTARY FOOD CHAINS SUPPLYING DATA, 1939

Article	Number of Organizations Handling Specified Articles under Own Brands			
	Among 20 Corporate Food Chains	Among 9 Voluntary Food Chains Wholesaler Members	Among 7 Voluntary Food Chains Headquarters	Total
Coffee	20	9	7	36
Canned vegetables	18	9	7	34
Salad dressing	18	9	6	33
Bread	17	1	5	23
All-purpose flour	17	8	6	31
Canned fruit	16	9	7	32
Canned milk	14	7	7	28
Prepared pancake flour	14	9	6	29
Canned salmon	11	8	7	26
Spices	9	6	6	21
Fruit gelatin	9	7	7	23
Farina	6	2	4	12
Baking powder	5	2	5	12
Corn flakes	5	7	6	13
White soap flakes	3	2	5	10
Granulated soap flakes	3	5	6	14
Canned soup	2	7	5	14
Perfumed soap	2	6	6	14
Kitchen cleanser	1	3	6	10
Floating soap	0	1	5	6
Baking soda	0	2	4	6

Similarly, among the 20 corporate chains, only 2 had their own brand of white soap flakes to compete with Lux and Ivory flakes. Among the 18 which did not carry such private brand flakes, 13 stated that the advertised brands were too strongly entrenched to permit them to develop satisfactory volume; 2 stated that no suitable source of supply was available; 2 stated that the margins obtainable on their own brand would not be sufficient to make it worth while; and 3 averred that the expenses of promoting their own brands to secure suitable volume would be too great. Similar reasons were given by the chains for not having their own brands of farina and corn flakes.

In short, in all the above instances, two conditions apparently were the chief preventives of entry into these merchandise fields: (1) the high cost of getting consumers to accept distributors' brands in substantial volume in competition with highly advertised manufacturers' brands; and (2) inability of distributors to buy such merchandise at prices which would permit them to offer an attractive price differential to consumers and at the same time to secure an attractive profit margin.

In contrast, these conditions did not hold for the items in Table 131 which were branded by the great majority of stores interviewed, such as coffee, canned vegetables, canned fruits, canned milk, salad dressing, and all-purpose flour. On these items it has been relatively easy for distributors to establish their brands. They are items in large demand. Moreover, favorable initial response to selling effort has not been too difficult to attain, for although there have been strong manufacturers' brands in certain of these fields, yet the storekeepers have found it possible to induce many consumers to shift brand allegiance. Again, they are products for which there have been numerous suitable sources of supply desirous of securing private brand contracts. In short, distributors have established their private brands first where conditions have made it easy to get a quick and profitable volume.

More detailed accounts of the reasoning of retailers regarding the branding of particular items were obtained from case reports. The views of two managements toward the branding of soaps and of another toward canned soup serve to illustrate the conditions and attitudes governing decisions.

The president of one large chain explained why his organization had never attempted to establish its own brand of soap. He stated that although soap had been a large volume grocery item, sales had been spread over many different types of specialized soaps. Leading soap companies had done much in improving their brands. He added that the competition among soap manufacturers had kept the wholesale price low, while competition among retailers had driven down retail prices until margins were at the vanishing point. Because of these margins his company would have liked to establish its own brand on numerous types of soap. But, according to the executive, it had been unable to buy good soaps at prices low enough to permit it appreciably to undersell the established brands and still have a desired gross margin. He thought a price differential of several cents a bar or package would be needed to win consumers away from the manufacturers' brands, and even with this differential considerable promotional outlay would be necessary.

In the latter months of 1938, executives of another large chain gave specific data regarding a possible entry into the selling of powdered soap under its own brand. This account is somewhat at variance with the preceding case in regard to the matter of opportunity to buy at a favorable price. It had under consideration the making of a contract with a soap manufacturer for a private brand of powdered soap to compete with Lever Brothers' Rinso and Procter & Gamble's Oxydol. At that time a case of 2 dozen 24-ounce packages of Oxydol cost the chain $4.46, while a similar size case of Rinso, in 23½-ounce packages, cost $4.48. The chain had opportunity to purchase a powdered soap at the favorable price of $2.67 a case of 2 dozen, 24-ounce packages. At that time, the chain was selling both Oxydol and Rinso at 19 cents a package, and securing a gross margin of approximately 2%. In spite of the fact that it could put out its own brand of soap powder at a price which would permit it to undersell the well-known brands by as much as 5 cents a package and still get a gross margin of 20%, the management hesitated to do so. There was some doubt as to whether the source would continue to offer the product on the same terms. Moreover, the chain was not sure whether consumers would like its brand of soap as well as the manufacturers' brands, even though the product had been given a good laboratory report. Because of these uncertainties the contract was not made, but early in 1941 the chain reported that it had found a dependable source and was about to put out its own brand of powdered soap. The executive interviewed stated that several acceptable sources for private brand soaps were then available.

Other case evidence gave similar reasons for the decision of a certain chain not to undertake sale of its own brand of canned soup. Executives did not think that they could attain a suitable volume with the desired net profit because manufacturers' brands sold at prices which the chain could not undersell. The secure position of manufacturers' brands was said to depend in part upon their advertising, in part upon the fact that consumers liked the quality, in part upon the low prices at which these products sold at retail. The chain found it difficult to buy private brand merchandise of suitable quality which it could offer at a saving which would attract consumers.

These more detailed reports indicate that when the prices of manufacturers' brands have been placed low enough to make it difficult for distributors or nonadvertising manufacturers to offer equally acceptable merchandise at attractive savings, private brand entrance has not been frequent. In the course of the study, certain manufacturers stated that the potential threat of private brand competition has led them to keep their prices low, with the result that such brands have not entered their fields.

That a manufacturer's pricing policy may play a dominant part in helping him to hold a leading position in a product field is illustrated in the case of Jell-O. In an address before the American Marketing Association in May, 1938,[1] Mr. Clarence Francis, President of General Foods Corporation, gave some facts regarding the pricing history of Jell-O and its unit advertising costs.

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[1] Clarence Francis, "A Challenge to Marketing Men," *The Journal of Marketing*, July, 1938, p. 31.

He stated that when General Foods took over the Jell-O Company in 1925, Jell-O was selling to the consumer for an average of 12 cents a package. In 1938, the prevailing retail price was around 5½ cents to 6 cents a package. The total advertising cost at that date was under ½ cent a pound.

Further evidence regarding the retail pricing of Jell-O and private brands of fruit gelatin was available in the survey among corporate and voluntary food chains. It was found that these organizations, in order to get desired gross margins on their private brands of fruit-flavored gelatins, had to sell them at prices which were only one-half cent a package below the retail price of Jell-O. Other manufacturers of fruit-flavored gelatins, such as Royal, sold at prices approximately the same as those for Jell-O. At a differential of one-half cent certain chains obtained substantial sales of their own brands of gelatin, but demand predominantly went to the manufacturers' brands. This leadership of manufacturers' brands is indicated by the consumer preference report of the Scripps-Howard survey in 1938,[1] which showed that among homes having gelatin desserts on hand at the time, 57.6% had Jell-O; 23.5%, Royal; 6.5%, Knox; 4.6%, Sparkle (A. & P. brand); while other brands accounted for 7.8%. In this instance large sales volume permitted substantial advertising of Jell-O at a low unit cost. In turn, the manufacturer's price did not include a large profit margin.

All the evidence given above regarding items offered under private brands indicates that in some fields the consumer does not have so great an option to buy distributors' brands on a price basis in competition with manufacturers' brands as he does in other fields. This limited option occurs particularly when manufacturers' specialty products have dominant brand leadership and the retail prices are so low that it is hard for the private brander to offer an effective price appeal under his brand. The fact that the retail prices of manufacturers are this low in such instances means that availability of the option would not be of large significance to consumers for they already get the products without unusually wide spread between manufacturer's cost and retail price.

Although the entry of private brands into some of these specialty product fields, such as the soap and canned soup fields, has been relatively slow, interviews with distributors showed a strong desire on their part to establish their brands on the items, because generally their gross margins and net profits, as a result of the price competition among retailers, have not been satisfactory to them. Consequently, in spite of the difficulties of entry, there has been a gradual extension of private branding into one after another of these fields. Thus consumer options in specialty fields have tended to increase.

In connection with this discussion of the options available to consumers in their purchasing, it should be pointed out that the choices available to consumers vary according to locality. In metropolitan districts where numerous retail organizations compete, one with the other, the options of the consumer are greater than in small towns and rural districts which cannot support such a large number of suppliers. Moreover, evidence regarding prices, obtained from extensive confidential surveys of prices in retail stores carried on by a private research organization, shows that price competition in metropolitan areas on both manufacturers' and private brands tends to be more intense than in small towns and rural areas, where suppliers are fewer. The prices which independent retailers pay and the prices which consumers pay are usually less in cities than in small towns and rural areas.

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[1] *Market Records*, 1938, p. 164.

VARYING PRICE DIFFERENTIALS BETWEEN DISTRIBUTORS' BRANDS AND MANUFACTURERS'

Distributors' brands have made their greatest gains in sales during periods of depression, when differentials between manufacturers' and distributors' brands have tended to widen and such savings have had increased appeal to consumers because consumers have become penny conscious at such times. Generally speaking, the prices of manufacturers' heavily advertised brands have not been sensitive. They have tended to be "sticky," particularly in periods of falling price, although there are numerous exceptions.[1] This characteristic is illustrated in the grocery field. Price indexes of foods in several categories were made available to our investigators by a large grocery distributor who built these indexes from his own purchase figures. These data, only selected items of which are given in Table 132, show that the index of advertised grocery items declined less frequently and less widely than did the index of all food prices. Its fluctuations were far less wide and less frequent than those of an index of so-called "grocery trading items," whose prices are so closely governed by the fluctuations of basic commodities that neither distributors nor manufacturers have appreciable influence over prices. Examples of such items are butter and flour. On the basis of October, 1929, as 100, the index of advertised grocery items reached a low of 75 in February, 1939. The price index of grocery trading items as of that date had fallen to 52; whereas the index for all food, including advertised items, grocery trading items, perishables, and meat, was about 62. Again, in the recession of 1937–1938, the index number of grocery trading items fell from approximately 82 in March, 1937, to a low of 65 for August, 1938. The index number for advertised brands kept rising, however, until September, 1937, when it was 89, and fell to a low of 86 in August, 1938.

Just as the prices of the advertised brands as a whole were shown by the data to be sticky in periods of depression, so they tended to be sticky in periods of rising prices; that is, the index for advertised brands did not rise so rapidly relatively as did the index for grocery trading items or the index for all foods. Consequently, the spread between the index of the advertised brands, on the one hand, and the index of grocery trading items and that for all foods, on the other hand, widened in periods of depression and became narrower in times of rising prices, as is indicated in Table 132. For example, at the depth of the depression in February, 1933, there was a spread of 23 points between the index number of grocery trading items and that of grocery advertised brands. In the months of relatively good business of late 1936 and early 1937, there was a spread of only 3 to 6 points between these two indices.

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[1] The fact that individual manufacturers with strongly advertised brands may follow a policy of adjusting prices in accordance with changing business conditions was shown in the case of one large company which sold numerous advertised grocery specialties. The average of this company's prices during the 1930 depression showed greater reduction than did the average prices for all foods.

TABLE 132

INDICES OF PRICES OF ALL FOODS, GROCERY TRADING ITEMS, AND GROCERY ADVERTISED BRANDS OF A CORPORATE FOOD CHAIN—FOR SELECTED DATES FROM OCTOBER, 1929, THROUGH DECEMBER, 1938

(October, 1929 = 100)

	Price Index Numbers		
	All Foods	Grocery Trading Items	Grocery Advertised Brands
October, 1929	100	100	100
December, 1930	84	75	95
December, 1931	75	64	90
December, 1932	66	58	85
February, 1933	62	52	75
December, 1933	70	68	80
December, 1934	76	77	85
December, 1935	84	78	87
December, 1936	83	81	87
March, 1937	82	85	88
December, 1937	80	74	88
December, 1938	75	64	86

The executive of one large chain stated that the private brand sales of his organization had made great strides during the 1929–1933 depression and again in the recession of 1937–1938. He claimed that at such times the chain had revised the prices of its merchandise downward more rapidly than had manufacturers as a whole. With the return of consumer buying power, he stated, and the narrowing of the spread between the chain's private brand prices and those of advertised brands, part of the advances reverted to the manufacturers' brands, but the chain's brands held an appreciable percentage of their gains. Executives of other chains gave similar evidence regarding appreciable gains on their own brands during depression, but did not claim retention of so large a part of their gains as did the executive mentioned above.

A specific example of a situation in which price differentials widened was provided by one chain, although this instance did not deal with a heavily advertised product. The chain increased its sale of green peas as a result of decreasing its prices more than those of a leading manufacturer's advertised brand during the depression of 1937–1938. The cost, pricing, and sales experience were as follows:

Leading Manufacturer's Brand—303 Can—17 Ounces

Year	Cost per Case	Retail Price per Can	Approximate Sales, in Cases
1937	$3.02 *	18 cents	3,000 *
1938	2.92 *	17 cents	2,600 *

Distributor's Brand—No. 2 Can—20 Ounces

1937	$1.10 †	15 cents	21,000 †
1938	0.80 †	2/25 cents	22,000 †

* Case of 24 cans. † Case of 12 cans.

In this instance the manufacturer's advertised brand was reduced about 3%, while the chain got its private brand peas at a reduction of 26%. The retail price of the manufacturer's brand was reduced 5.5%; the private brand, 16.7%. Sales of its brand increased 5% while sales of the manufacturer's brand decreased 13%. These ratios should be looked upon as merely those found in one case rather than as typical, for it is doubtful whether there is a typical case. The situation, however, illustrates the fact that private branders have gained when their prices have been lowered during depressions more than those of manufacturers' brands.

While this evidence regarding the relative sensitivity of prices of private brands and manufacturers' brands is too meager to support definitive conclusions regarding the pricing practice of the two groups in periods of falling prices, still it is sufficient to suggest that manufacturers of many advertised brands might well consider whether they have permitted their prices to get out of line with private brand prices in periods of depression. They should give careful consideration to the effect of price upon the demand for their products and inquire whether they have taken a mistaken view that their advertising has created an inelastic demand for their brands.

. . . .

THE EFFECT OF ADVERTISING ON THE RANGE AND QUALITY OF PRODUCTS

RELATION OF ADVERTISING TO QUALITY UNDER BRANDS

The desire of a seller to maintain quality under his brand does not depend upon his being an advertiser. He maintains quality under his brand in order to enjoy the benefits of patronage of satisfied customers, whether he advertises extensively or not. Thus, the survey made by this study of the selling of private brand merchandise by large-scale distributors disclosed that these concerns were maintaining some kind of control over the quality of products sold under their labels. The methods reported by the various types of organizations are shown in Table 136. Since these concerns employed different methods for different types of products, the totals of methods reported exceed the number of concerns interviewed. The most common practices reported were periodic submittal of samples of merchandise to laboratory test and dependence upon suppliers in whom they had confidence to maintain quality control. A large percentage reported that they physically inspected merchandise. Some organizations had established their own laboratories. For example, 10 out of 20

TABLE 136

METHODS EMPLOYED BY CERTAIN LARGE-SCALE DISTRIBUTORS TO MAINTAIN QUALITY OF MERCHANDISE SOLD UNDER THEIR OWN BRANDS, BUT NOT MANUFACTURED BY THEM, 1939

Method Employed for Checking Quality *	Number of Replies as to Methods Used Among						
	20 Corporate Food Chains	13 Corporate Drug Chains	11 Voluntary Chains Wholesaler Members	7 Voluntary Food Chains Headquarters	5 Limited Price Variety	5 Dry Goods and Dept. Store Chains	Total
(a) Keep inspectors in suppliers' plants....	1	0	0	3	0	0	4
(b) Use systematic physical inspection of merchandise........	16	0	10	3	1	3	33
(c) Submit samples periodically to laboratory test...........	14	8	6	4	4	3	39
(d) Rely upon grading by government inspectors (applies to meats and canned foods).............	4	0	4	6	0	0	14
(e) Depend primarily upon suppliers to maintain quality of specification or of sample submitted...	14	10	5	0	5	5	39
(f) Rely on integrity of supplier without specification or sample................	1	0	0	0	0	0	1

* Many organizations reported using different methods for different products. Hence the total reported methods are greater than the number of concerns reporting.

corporate food chains interviewed had their own testing laboratories, 5 out of 13 corporate drug chains, and 2 out of 11 voluntary food chains. Others submitting products to laboratory check used commercial laboratories. The adequacy of these control systems was not closely studied, but every management was alert to the need of maintaining quality.

Some manufacturers supplying private brands to distributors stated that they exercised less rigorous quality control over merchandise manufactured for distributors' brands than over that sold under their own brands. This was true, for example, of one sheet manufacturer and of a hosiery manufacturer. Others, however, stated that their control over private brand merchandise was as rigorous as that given to their own brands, and in many instances identical merchandise was sold under the producer's brand and distributors' brands.

While maintenance of quality for a brand does not depend upon advertising, advertising usually intensifies the desire of a manufacturer to maintain quality in order to protect the goodwill which adheres to his brand. Manufacturers are wary of letting quality deteriorate when they have a large volume of business gained at considerable cost. It was found in field work that without exception manufacturers had established quality controls for their advertised branded products. The efficiency of their control systems was not studied, but the importance they attached to maintaining quality was evident.

The Range of Products Available

The advent of new inventions and the quest for product differentiation have brought an enormous number of products on the market from which consumers may choose. This fact is indicated in the following quotation:

> At any one time, there are now available about a quarter of a million distinct goods, each vying for a share of the consumer's dollar. A committee of experts, working for the Consumer's Advisory Board, recently listed about 100,000 important commodities, of which at least 2,000 were of key significance. The 1929 catalogue of Sears, Roebuck and Co. described more than 46,000 items; while the drug department alone of Macy's in New York City offers its customers their choice of some 20,000 items. No attempt has been made to count the total number of things sold throughout the store. Nor has any such census been made for the nation as a whole.[1]

The number of distinct commodities on the market is large, but such a figure is small in comparison with the number of brands in the country, because each commodity has many suppliers who brand their goods. No one knows how many there are. The study of shoes indicated that there were in excess of 6,000 brands of shoes on the market. Estimates of unknown validity have been published regarding the number of brands of various other products, e.g., 300 brands of canned pineapple, 1,000 of canned salmon, 4,500 of canned corn, 2,500 of perfume, 1,200 of face powder, 500 of mustard, 10,000 of wheat flour, and so on.[2] In the neighborhood of 375,000 certificates of registration for trademarks had been issued by the U.S. Commissioner of Patents through 1940, but

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[1] C. S. Wyand, *The Economics of Consumption* (New York, Macmillan, 1937), p. 117.

[2] Such estimates have appeared in a number of books on consumption, but it has been impossible to trace the estimates to original sources.

TABLE

PRODUCTS—USAGE BY BRANDS AND RETAILER STOCKING OF BRANDS

Commodity	% of Families Reporting Use of Product	No. of Brands Reported in Use	Percentage of Families Consuming Product Who Used Leading Brands			No. of Brands Used by Less Than 1% of Consumers
			No. 1	No. 1–3 Inc.	No. 1–5 Inc.	
Packaged coffee	84.0	148	25.0	52.0	65.0	129
Coffee substitute and decaffeinated	9.5	12	56.0	100.0	...	9
Packaged cocoa	85.0	80	34.0	76.0	86.0	71
Corn breakfast foods	78.0	10	90.0	102.0	....	7
Bran breakfast foods	36.0	12	43.0	80.0	101.0	6
Wheat breakfast foods	51.0	29	24.0	72.0	96.0	19
Quick oat breakfast foods	75.0	25	93.0	95.0	97.0	21
Rice breakfast foods	34.0	15	50.0	100.0	...	12
Canned peaches	57.0	102	68.0	82.0	88.0	91
Canned pineapple	76.0	99	62.0	84.0	90.0	90
Canned soups	84.0	50	84.0	100.0	103.0	45
Canned milk	67.0	39	32.0	75.0	93.0	30
Canned pork and beans	82.0	41	72.0	97.0	99.0	34
Bottled catsup	86.0	76	45.0	88.0	91.0	70
Tomato juice	27.0	80	37.0	59.0	70.0	61
Wheat bread	88.0	27	28.0	57.0	76.0	14
Packaged soda crackers	94.0	38	69.0	89.0	93.0	30
Packaged cookies	28.0	26	80.0	90.0	96.0	19
Packaged macaroni	78.0	108	57.0	79.0	85.0	99
Baking powder	99.0	44	65.0	84.0	95.0	37
Baking chocolate	74.0	24	71.0	96.0	100.0	18
Prepared cake flour	55.0	20	66.0	100.0	101.0	16
Flour	94.0	66	41.0	78.0	88.0	57
Packaged compressed yeast	45.0	8	52.0	102.0 ‡	102.0 ‡	8
Quick dessert powders	66.0	81	46.0	74.0	88.0	68
Packaged cheese	61.0	43	52.0	85.0	94.0	31
Salad dressings—boiled	45.0	32	69.0	92.0	96.0	25
—mayonnaise	40.0	53	40.0	87.0	95.0	47
Sugar in cartons	14.0	9	49.0	99.0	99.0	6
Granulated sugar in cloth bags	88.0	61	25.0	60.0	80.0	48
Smoked ham	63.0	28	49.0	87.0	100.0	23
Packaged bacon	71.0	31	47.0	85.0	98.0	25
Toilet soap	99.0	86	29.0	80.0	104.0	76
Packaged soap flakes	82.0	72	38.0	79.0	98.0	60
Granulated soap or soap beads	56.0	36	69.0	146.0	173.0	30
Washing powder	10.0	44	69.0	80.0	87.0	34
Scouring cleansers	90.0	43	45.0	80.0	93.0	35
Brown laundry soap	65.0	36	65.0	90.0	99.0	31
White laundry soap	58.0	28	53.0	94.0	99.0	23

Commodity	% of Families Reporting Use of Product	No. of Brands Reported in Use	Percentage of Families Consuming Product Who Used Leading Brands			No. of Brands Used by Less Than 1% of Consumers
			No. 1	No. 1–3 Inc.	No. 1–5 Inc.	
Aspirin	78.0	71	88.0	95.0	...	68
Cigarettes	72.0	29	30.0	78.0	95.0	19
Pipe tobacco	45.0	87	14.0	37.0	51.0	71
Perfume	49.0	181	56.0	69.0	77.0	166
Mouth wash	69.0	118	47.0	78.0	88.0	111
Tooth paste	82.0	99	24.0	53.0	72.0	86
Tooth powder	33.0	63	67.0	85.0	89.0	55
Safety razor blades	87.0	127	56.0	78.0	89.0	121
Shaving cream	55.0	100	39.0	67.0	79.0	89
Brushless shaving cream	18.0	44	27.0	68.0	94.0	33

* Chain brands.
† Wholesaler or cooperative chain brand.
‡ Only two brands given.
§ Range—3 to 25 brands; Mode—15 to 20 brands.

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—SELECTED PRODUCTS IN THE GREATER MILWAUKEE MARKET—1935

Percentage of Retailers Carrying Number of Brands Indicated							Percentage of Coverage among Retailers by Brands with Standing							
							No. 1		No. 3		No. 5		No. 10	
0	1	2	3	4	5	Over 5	Ind. Grocers	Chain	Ind. Grocers	Chain	Ind. Grocers	Chain	Ind. Grocers	Chain
....	2.5	2.0	7.5	7.5	11.0	70.0	0.0	33.0*	60.0	100.0	27.0	100.0	0.0	33.0*
14.5	39.5	30.5	14.5	1.0	....	....	78.0	100.0	27.0	100.0				
1.5	22.5	34.0	28.5	10.0	2.0	1.5	69.0	100.0	27.0	67.0				
0.5	18.0	48.5	31.5	1.5	....	....	96.0	100.0	45.0	33.0				
3.0	12.0	22.5	27.5	26.0	6.5	2.5	86.0	100.0	77.0	100.0	30.0	100.0		
2.0	2.0	8.0	11.5	14.0	18.0	45.0	83.0	100.0	77.0	100.0	51.0	100.0	0.0	33.0*
0.5	68.0	25.5	5.5	0.5	....	....	94.0	100.0	0.5	33.0				
4.5	15.5	40.0	33.0	6.0	1.0	....	74.0	100.0	59.0	100.0				
1.5	16.5	32.0	24.0	10.5	8.0	7.5	29.0	100.0	0.0	33.0†	7.0†	0.0	3.0†	0.0
1.0	16.0	21.5	27.0	18.5	8.0	8.0	33.0	67.0	30.0	33.0	0.0	33.0*		
0.0	3.5	9.0	16.5	23.5	18.5	29.0	97.0	100.0	52.0	100.0	0.0	67.0*		
0.5	10.5	29.0	36.5	16.5	3.5	3.5	79.0	100.0	25.0	100.0	64.0	0.0		
0.0	11.0	28.5	36.5	20.0	2.5	1.5	90.0	100.0	8.0	66.0	0.5	0.0		
0.5	7.0	18.5	30.0	24.0	12.0	8.0	82.0	100.0	26.0	0.0	0.0	33.0		
16.5	46.5	21.5	7.5	4.0	1.5	2.5	20.0	100.0	9.0	67.0	18.0	0.0	4.0	33.0
0.0	1.5	1.5	14.5	34.0	32.5	16.0	90.0	33.0	0.0	0.0	65.0	0.0	0.0	33.0
0.5	41.0	33.0	16.0	6.0	3.0	0.5	89.0	0.0	29.0	0.0	1.0	33.0		
14.5	32.0	28.5	10.5	8.0	4.5	2.0	40.0	0.0	1.0	33.0	0.5	33.0		
0.5	36.5	40.5	17.5	3.5	1.5	0.0	76.0	100.0	14.0	33.0	3.0	0.0		
0.5	8.5	14.0	25.5	28.5	17.5	5.5	95.0	100.0	38.0	100.0	0.0	0.0		
1.0	35.5	44.5	16.0	3.0	....	....	92.0	100.0	24.0	100.0	3.0	0.0		
6.0	38.5	27.5	24.5	3.0	0.5	0.0	81.0	100.0	51.0	100.0				
0.0	20.0	32.5	20.5	16.5	6.0	4.5	45.0	100.0	40.0	0.0	0.0	33.0		
1.0	51.5	47.0	0.5	....	....	....	72.0	67.0	Only 2 brands given					
...	4.5	5.0	9.5	10.5	13.0	57.5	86.0	100.0	66.0	100.0	46.0	67.0	13.0	33.0
3.5	5.5	9.0	17.0	17.5	20.0	27.5	84.0	100.0	23.0	0.0	63.0	100.0	20.0	67.0
0.5	30.5	38.0	22.5	8.0	0.5	....	91.0	100.0	57.0	67.0	0.0	33.0		
3.5	38.5	36.5	16.5	4.5	0.0	0.5	74.0	100.0	41.0	100.0	4.0	0.0		
18.0	64.5	16.0	1.5	. .	....	....	56.0	33.0	17.0	0.0				
37.0	45.5	16.5	0.5	0.5	....	....	8.0	0.0	21.0	33.0	0.0	33.0	0.5	0.0
69.0	22.5	7.0	1.0	0.5	....	....	9.0	100.0	5.0	100.0	0.0	0.0		
58.0	38.5	3.0	0.5	0.0	....	....	11.0	100.0	9.0	33.0	2.0	0.0		
	Under 5 brands			0.5	....	99.5	89.0	100.0	92.0	100.0	99.0	100.0	0.0	0.0
...	1.5	8.0	11.5	14.0	14.0	51.0	31.0	100.0	77.0	100.0	68.0	100.0	22.0	100.0
0.5	3.0	7.0	17.0	28.5	28.0	16.0	97.0	100.0	83.0	100.0	24.0	100.0		
10.0	45.5	29.5	12.0	2.5	....	0.5	83.0	100.0	21.0	0.0	0.0	0.0	4.0	0.0
0.5	2.0	9.0	12.5	26.0	22.0	28.0	88.0	100.0	54.0	100.0	78.0	67.0		
1.0	14.0	32.0	32.0	19.0	1.5	0.5	88.0	100.0	37.0	100.0	49.0	67.0		
0.5	18.5	49.0	23.0	7.0	2.0	0.0	92.0	100.0	99.0	100.0	1.0	0.0		

Percentage of Druggists Carrying Number of Brands Indicated							Percentage of Coverage among Druggists by Brands with Standing							
							No. 1		No. 3		No. 5		No. 10	
0	1	2	3	4	5	Over 5	Ind. Druggists	Chain	Ind. Druggists	Chain	Ind. Druggists	Chain	Ind. Druggists	Chain
...	2.0	23.0	48.0	15.0	9.0	3.0	99.0	Yes	0.0	Yes				
....	...	.	....	....	....	100.0§	96.0	Yes	94.0	Yes	91.0	Yes	90.0	Yes
....	...	1.0	....	....	....	99.0	93.0	Yes	91.0	Yes	94.0	Yes	86.0	Yes
....	. ..	41.0	....	....	....	59.0	89.0	Yes	21.0	Yes	50.0	No	25.0	No
....	....	....	....	....	....	100.0	95.0	Yes	97.0	Yes	0.0	No		
....	....	....	....	....	....	100.0	92.0	Yes	82.0	Yes	91.0	Yes	96.0	Yes
....	....	....	3.0	8.0	5.0	84.0	97.0	Yes	59.0	Yes	54.0	No		
....	....	....	3.0	....	5.0	92.0	97.0	Yes	71.0	Yes	82.0	Yes		
....	....	....	....	2.0	1.0	97.0	80.0	Yes	83.0	Yes	85.0	Yes	1.0	Yes
....	....	....	4.0	7.0	6.0	83.0	97.0	Yes	79.0	No	49.0	No	19.0	No

Source: Based on data from *The Milwaukee Journal*, "Consumer Analysis of the Greater Milwaukee Market—1935."

such a figure fails to reflect the number of brands on the market, because many marks in use, particularly marks not in interstate commerce, are not registered.

While astronomical figures of number of brands may be compiled, a better idea of the array of brands from which consumers may choose is conveyed by the list of brands for specific products to be found in individual city markets, for many brands have only limited distribution. A list of brand choices available for selected consumer products in the Greater Milwaukee market is given in Table 137. This table shows for these products not only the number of brands in the market but also the number carried by individual stores and the distribution of demand among the various brands available, facts upon which comment will be made later. The choices available in a market such as Milwaukee are numerous for most products: 148 brands of packaged coffee, 10 brands of corn breakfast foods, 29 brands of cigarettes, 87 brands of pipe tobacco, 99 brands of tooth paste, 100 brands of shaving cream, and so on. The number of brands available in city markets is, of course, far larger than the number available in small towns and rural districts, where the number of retailers is smaller.

ADVERTISING RELATIONSHIP TO THE NUMBER OF BRANDS

While advertising and aggressive selling strengthen the tendency toward nonstandardization of merchandise and have encouraged continuous attempts at new differentiation, strangely enough advertising has been a force which has often tended to decrease the number of brands upon the market. The number of brands in any merchandise category is attributable not to the practice of advertising, but to the number of suppliers who find it profitable to sell such merchandise under their brands. Instead of being a force to increase the number of brand choices, advertising is a force tending to concentrate demand upon certain brands. Those employing selective advertising hope to attract a large volume of demand for their brands.

Many forces, of which advertising is but one, enter into determination of the number of suppliers of particular products in any market. Important among these forces is the presence or absence of decreasing production costs with increasing scale of operations. Chiefly because of the economies of large-scale operation, the number of companies is small in the automobile, electric refrigerator, and sugar industries. Accordingly, brands are few. In contrast, the advantages from large-scale operation have not been present in such degree in the manufacture of canned fruits, shoes, macaroni, or flour; and the number both of suppliers and of brands has been relatively large. Among other considerations which have a bearing on the number of suppliers are the capital outlay required (usually associated with the phenomenon of decreasing costs), the effect of freight charges, and the volume of demand in the market to support a number of suppliers. To the above, advertising may be added as another force which has often been employed to bring concentration of demand on a few suppliers. In bringing concentration of demand it has had some, though not strong, influence in keeping down the number of brands. That advertising has some influence on the number of brands has been shown in the analyses of competition in the cigarette and dentifrice fields. Likewise in the cigar industry, advertising, since 1917, has been added to the force of decreasing manufacturing costs to bring concentration of demand, to reduce the number of suppliers, and thus to reduce the number of brands. Whenever advertising has been effective in building strong brand discrimination, this discrimination for established brands has been one factor to discourage the entry of new brands into the market, and has required any new entrant to make considerable outlay for aggressive selling costs to secure substantial volume. A number of cases were found in which manufacturers decided against entry into certain product fields because of the strongly entrenched positions of leading advertised brands. Again, the survey among chains showed that private branders have delayed entry into product fields in which the strong domination of manufacturers' brands has made the establishment of private brands difficult and expensive.

Varying combinations of the forces governing the number of suppliers in the market account for the varying number of brands in different fields, such as are shown in Table 137. While advertising has had some effect on the entry of brands into the market, it has apparently not been a strong force in itself in keeping down the number of brands. In a number of fields in which advertising has played an important role in marketing and in which manufacturers' brands have been dominant, the total number of brands has continued to be large because forces other than advertising have favored easy entry of suppliers. For example, in 1935 there were 99 brands of tooth paste used in the Greater Milwaukee market. In this field it has been feasible for a large number of suppliers to enter manufacture, and to sell small volume with some profit, because little capital outlay has been required and no great production economies have attended large-scale manufacture. Yet advertising has been a force to discourage an even larger number of brands, as shown by the fact that 72% of the demand for tooth paste was concentrated in five extensively advertised brands. Likewise with shaving cream, the lack of economies in large-scale production and the small amount of capital required for manufacture led 100 concerns to put out shaving cream under their brands in the Milwaukee market, but nearly 80% of the demand was concentrated in five advertised brands. In contrast, in the case of cigarettes, the large outlay required for starting to manufacture was one force tending to hold the number of brands of cigarettes to 29, but on top of this was the restraining influence of the large advertising outlay needed to establish new brands, until the manufacturers of 10-cent brands entered the market without such outlay.

Thus when considering the problem of consumers' difficulties in getting the "best" value among a large number of brands in the market, one should realize that advertising in itself has been a force tending to bring uniformities of demand. It has led consumers to center concentration upon a smaller array of brands than probably would have been present were advertising not a strong factor in influencing selective demand.

While advertising has been a force tending to keep down the number of brands in some fields, at the same time its effect has been to keep alive in the minds of consumers the possible benefits of the differences offered in various brands. Consequently for many convenience products retailers have found it advisable to carry a substantial number of the available brands in order to meet the preferences of their clientele. Thus Table 137 shows that in Milwaukee 70% of the retailers carried over five brands of packaged coffee; 99.5% carried more than five brands of toilet soap; every retailer found it necessary to carry over five brands of cigarettes, and the modal number carried was 15 to 20 brands in spite of the fact that the total number of brands in the market was small in comparison with those for many other product groups. And so on with other products, such as tooth paste, tooth powder, safety razor blades, and shaving cream, for which differentiation and brand preferences were strong, the number of brands carried by retailers was large.

In contrast, for products for which brand discrimination was low and consequently advertising was not an important marketing tool, the number of brands carried by individual retailers tended to be small in relation to the total number of brands in the market. Retailers did not need to carry many brands, because consumers did not have strong enough brand preferences to make the offering of a wide variety of brand choice on the part of the retailer necessary. Although there were 102 brands of canned peaches in the market, the great majority of retailers found it necessary to handle only three brands or less; and so it was with canned pineapple, wheat bread, flour, mayonnaise, and many other products.

The number of brands carried by retailers appears to be a function of variety of choice demanded by consumers. When differentiation among competing brands has appeared of importance to consumers, the retailer has found it necessary to carry a considerable number of brands to satisfy demand. Where brand has offered differentiation of little consequence, the retailer has not been pressed to carry a large number of brands.

It is concluded from the above discussion that advertising in itself has been a force tending to reduce the number of brands upon the market, but it may have increased the number carried by individual retailers in some categories because it has helped to make product differentiation of consequence to consumers in guiding their demand.

SUMMARY

The evidence . . . shows that advertising, as an important element in an aggressive, free enterprise, has been an indirect influence in bringing the remarkable range of products now available to consumers. It has thus contributed to an enhancement of consumer satisfactions. It has helped in the growth of product range through its part in speeding up the adoption of major inventions. It has had an even greater influence on range of merchandise through its encouragement of product differentiation. Because of their desire to find products which might prove desirable to consumers and which accordingly they might aggressively promote to consumers, sellers have been led to constant experimentation in combining product qualities.

In thus stimulating differentiation, advertising has had an influence in bringing progress in merchandise development. Improved products have come on the market which better fill consumer desires and needs than the old products. This product improvement has been rapid and striking in the case of relatively new products such as automobiles, refrigerators, and other mechanical products. But even for merchandise long on the market the improvement has been substantial over a period of time. The constant striving for product improvement has brought significant improvements in products such as gasoline and sheeting, which at any time appear to critics to be relatively standardized. A time span must be observed if one is to discern the full effect of the drive for differentiation upon product improvement.

In addition to its effect in stimulating improvement, advertising has also influenced maintenance of product quality under brands, because sellers have been anxious to retain the goodwill which brand advertising has helped to build.

THE PROCESS OF EVALUATION

BY MABEL TAYLOR GRAGG

IN COLLABORATION WITH NEIL H. BORDEN

Each of the six steps itemized below is a necessary part of the process of evaluation. At each of these steps numerous arbitrary decisions ordinarily must be made. And each of these decisions will have some effect upon the final evaluations. The six steps in evaluation are:

1. Classifying the units which are to be evaluated.
2. Deciding upon the qualities to use as criteria for judging worth.
3. Defining the criteria in terms susceptible of measurement.
4. Deciding how many and which units are to be examined.
5. Making the measurements.
6. Translating the findings into a usable form.

The task of this present section is to describe briefly the more important issues encountered during the execution of these various steps in the process of evaluating merchandise. Later sections will deal in greater detail with these issues and with their significance from the point of view of consumers.

STEP 1: CLASSIFICATION OF MERCHANDISE

In any formal process of evaluation the units to be appraised must be compared either with each other or with some absolute standard. Unit A, that is, may be said to be as good as, or better than, or worse than, units B, C, D, and so on, or it may be said to equal, exceed, or fall short of the standard for units of its class.

Source: Excerpts from *Merchandise Testing as a Guide to Consumer Buying* (Harvard Business School, Division of Research, Business Research Studies, No. 22, 1938), pp. 9–26, 81–84.

The problem of how many and what types of products to group together in any given class may seem to be both simple and unimportant. Actually it is neither. In fact, this question of what products are to be compared is in many respects the most vital of all the questions involved in merchandise evaluation. An item of merchandise termed "best," "second best," "Grade A," "satisfactory," or otherwise valued can be accepted as deserving of the designation only in relation to the goods comprehended in a particular group. If objective information, rather than a rating is given, for example to the effect that the product will do a particular thing, the significance of the information from the point of view of sound product selection is dependent upon comparable evidence as to what other products will do.

If worthy merchandise with which a product should be compared is excluded from the comparison, whether by reason of its newness, for lack of time to make additional comparisons, or for other cause, the value designation or objective evidence as to merit may have little meaning. Similarly, if goods are included in a group to which they do not properly belong, the resulting comparisons may be useless to consumers.

Almost any piece of merchandise can be made to appear either good or bad, depending upon the things with which it is compared. A rayon stocking may be the best rayon stocking on the market; yet, if it is put in a classification with silk stockings, it may show up badly by comparison. A carpet sweeper classed with electric cleaners will fare differently from what it would if classed with other carpet sweepers.

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It is evident that product classifications can be set up which result in comparisons that have little or no significance for consumers. The problem of deciding what comparisons have importance, or the most importance, to consumers often is a difficult one. The number of product groups that logically can be recognized commonly is very large. The purchasing department of one of our large cities, for example, has separate specifications for 20 classes of pencils.

EXAMPLES OF PROBLEMS MET IN CLASSIFYING MERCHANDISE

In the case of shoes, the question arises as to how many and what classifications should be recognized, and how many ratings given or standards set. Any of the following bases, for example, might be used for a classification: leather shoes, cloth shoes, work shoes, dress shoes, women's, men's, and children's shoes, high heels, low heels, rubber soles, leather soles, corrective shoes, oxfords, strap shoes, sandals, turned shoes, cemented shoes. Further, there is a question as to whether the classification should recognize price lines. That is, does the consumer wish to know which $5 street shoe is the best, or does he wish to know which of all street shoes is the best?

In the case of cooking utensils, to take another example, all cooking pans might be classed together or separate classes and standards might be established for aluminum pans, tin pans, copper pans, glass pans, and enamel pans.

Different classifications also might be recognized for pans intended for different uses: frying, boiling, and baking—home use, restaurant use, and so on. There might be one class for enamel pans that can be bought in variety chain stores for 20 cents and another class for enamel pans sold in hardware and department stores for $1 or more. Does the consumer wish to know which of the 20-cent pans are better or does she wish to know whether the $1 pans are better than the 20-cent pans?

In the case of mattresses, many classes might be set up: inner spring; hair; cotton; felt; kapok; straw; and the various combinations possible among these materials and by price lines.

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STEP 2: SELECTION OF PRODUCT QUALITIES TO SERVE AS CRITERIA

The criteria by which the products in a given class are to be judged may be stated in the form of legal requirements or in the form of standard specifications, or their selection may be left to the discretion of the persons making the evaluations. The question, of course, is: What makes the products good or bad? What, for example, makes a good egg beater? Durability? Quickness with which it can perform a given task? Quality of the performance? Perhaps it is important whether the handle is covered with paint that is likely to chip and fall into the eggs.

The National Bureau of Standards, in developing specifications, commonly accepts qualities of existing products that have proved satisfactory in use as the criteria to be followed. Essentially the same procedure, of using the qualities of existing satisfactory products as criteria, has been followed by the Department of Agriculture in setting up grades for canned goods. At any rate, in any product evaluation, the qualities or aspects of the product which it is thought worth while to examine must be decided upon at some point. And when the qualities or aspects to be considered have been selected, the terms must be defined and standards for measurement decided upon. If sharpness is to be the criterion, agreement must be reached as to what is meant by sharpness and how much sharpness is to be taken for the standard. This present section deals only with the selection of the qualities to be measured; definition of those qualities in terms of measurement is treated in the following section.

EXAMPLES OF PROBLEMS MET IN SELECTING CRITERIA

It is obvious that an improper selection of criteria can render any test meaningless. For example, in the case of lubricants for use in internal combustion engines, the ability of the lubricants to reduce friction commonly is accepted as a criterion of their suitability, it being assumed, very reasonably it might seem, that whatever reduces friction also will reduce wear. Nevertheless, experiments have been made which indicate that this may not be the case; that friction and wear may not correlate.[1] If this conclusion is correct, then tests to determine the effect of lubricants on engine wear have no validity provided the degree of friction is accepted as the criterion.

In the case of consumers' goods, it is evident that the criteria should be concerned with those qualities of the product which either are, or should be, of moment to the users. Determination of what those qualities are may be far from simple. Many people may like the same product, but their reasons for doing so may be very different; and one person's reasons for liking the product may be another's reasons for disliking it. Furthermore, in the case of many products there are numerous small characteristics which, though seemingly too unimportant to be made the subject of a test, nevertheless may have much to do with the satisfactoriness of the goods.

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The U.S. Commercial Standard for woven dress fabrics recognizes as criteria: breaking strength; color fastness to crocking; color fastness to cleaning, dry and wet; color fastness to dry pressing; color fastness to laundering; color fastness to light; color fastness to perspiration; shrinkage in cleaning, dry and wet; shrinkage in laundering; resistance to yarn slippage.[2] This would seem to be an adequate list, and yet, even though a fabric passed tests designed to measure all these qualities it might still not be entirely satisfactory. It might happen, for instance, that although the residual shrinkage was small it was not uniform, so that a dress made from the fabric would not hang evenly after being washed.

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[1] In the *S.A.E. Journal*, December, 1937, p. 548, in a paper entitled "High Oiliness—Low Wear?" G. L. Neely, Standard Oil Company of California, writes:

"In our investigation of addition agents for lubricating oils, one of the most striking observations has been that the great majority of oil-soluble compounds will reduce the coefficient of friction for some operating condition. It is, therefore, a simple matter to find an addition which merely improves oiliness. The effectiveness of such compounds on the wear-reducing value of the lubricants often may be considerably different in degree, and sometimes in direction, from the effect on friction."

After describing the testing procedure he followed and the testing machine he used to determine the effects of different types of addition agents on friction and wear, Mr. Neely goes on:

". . . The addition [to the lubricants] of Compounds A and B was, in effect, the same as reducing the load as is shown by the fact that the points for the oils containing these compounds, 1-A and 1-B, fall on the line joining the points obtained at various loads with Lubricant No. 1. Thus the friction-reducing value was indicative of wear-reducing value with these two compounds. However, Compound D had entirely different characteristics in that the wear with Lubricant 1-D was reduced to a far greater degree than was the friction. Compound C had an intermediary effect.

"On the other hand, the addition of Compound E to Lubricants 1 and 2, while slightly reducing the friction, greatly increased the wear. . . .

"Lubricants Nos. 5 and 6 are of interest in that they show that it is possible to obtain extremely small amounts of wear and yet possess relatively poor friction-reducing properties. *These data illustrate the futility of attempting to predict wear-reducing value from friction tests.*" [Italics not in original.]

Whether Mr. Neely's experiments were valid and his conclusions correct is of no interest for the moment. The experiments are cited at this point merely to indicate how difficult it may be to choose a proper criterion for testing a product.

[2] U.S. Department of Commerce, National Bureau of Standards, Commercial Standard CS59-36, *Woven Dress Fabrics, Testing and Reporting*, pp. 2 et seq.

In the case of canned peas, what should be tested? Size of the peas? Flavor? Closeness of the pack? Tenderness? Color? Type of can used? These are not questions that answer themselves or to which demonstrably right answers can easily be found.

Two Types of Criteria

Criteria conveniently may be divided into two general classes depending upon whether they refer to what a product is or to what it can do. Those in the first class are concerned with the product as a thing in itself, with its inherent chemical and physical properties. Criteria of the other type measure the product in terms of performance. They are concerned with the product in a dynamic state, in relation to other things and situations.

Analysis criteria involve such questions as: Is it silk? Is it soda? Is it handmade? Is it riveted? How many threads are there to the inch? How much does it weigh? What color is it? What is the fat content? Criteria of performance, on the other hand, are concerned with such questions as: How long will it wear? How comfortable will it feel? Will it stop a cough? Will it make me fat? How much electric current will it use? Both types of criteria may be applied to the same product. Throughout this discussion of product evaluation, however, it will be found helpful to keep the distinction in mind.

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Step 3: Definition of Criteria in Terms of Measurements

After it has been decided what qualities or aspects of the commodities grouped in a certain class are important as criteria for judging merit, it then is necessary to define the criteria in terms susceptible of measurement. Before the "durability" of a product can be measured, for example, what is meant by durability must be stated in specific terms; that is, in terms of specific standards and test procedure.

Examples of Problems Met in Defining Criteria

Color fastness to laundering of wash dress fabrics predominantly silk or rayon, for instance, is defined by the National Bureau of Standards as being "a degree of color fastness equal to that of standard sample DF7" shown by such fabrics when subjected to the following washing procedure: [1]

> **Washing Procedure.** The specimen . . . is placed in a 1-pint preserve jar to which is added 300 ml of a solution containing 0.5 per cent of neutral soap in soft water heated to 100± 2° F. The jar is then covered, placed in the machine, and rotated for 30 minutes. The machine is heated to maintain a constant temperature of 100± 2° F. The specimen is removed from the jar, rinsed in three changes of water at 100± 2° F, rolled in a dry towel or absorbent cotton cloth to remove excess moisture, spread on a padded ironing board, and pressed until dry with a flatiron having a temperature between 275 and 300° F. The specimen is allowed to lie on a smooth, horizontal surface for 1 hour at room temperature.

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[1] *Ibid.*, p. 7.

The correct procedure for measuring product qualities commonly is not obvious.[1] There are standard test methods for certain product characteristics, but not for more than a small part of the tremendous number that are important to users of consumers' goods.

Consider the case of the egg beater whose length of life is to be forecast. One testing agency, as part of its testing procedure for egg beaters, attaches the beaters to an electric motor and has them beat axle grease until they are worn out. Several obvious criticisms can be leveled at this procedure, as no doubt would be the case regardless of what method was followed. In the first place, in the test, the beaters are operated continuously rather than intermittently as would be true in practice. In the second place, egg beaters are not required ordinarily to beat axle grease; had some other substance been employed, different results might have followed. And, in the third place, the procedure tested durability only to beating and not to other possible causes of wear such as being knocked about in a drawer or kitchen sink. The important point to note, however, is not the criticisms which can be made of the particular procedure used in this test, but the fact that those conducting the test were called upon to make a number of arbitrary decisions as to procedure. They also, of course, would have to decide how long a beater should be required to operate under the test conditions in order to be satisfactory; in other words, what is to be the standard for judging the product under the procedure selected.

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MEASUREMENT OF CHEMICAL AND PHYSICAL CRITERIA

The technique of testing when the criteria are chemical and physical properties is far more advanced and far more standardized than is the technique of performance testing. There is in many cases a definitely "right" test method to follow and, within limits, the right method will give the desired answers.

Even in this field of testing chemical and physical properties, however, methods are not always so routine and results as sure as the layman is inclined to think. As a chemist on the staff of a large commercial testing organization explained: "If you brought me a liquid and asked me to tell you whether certain specific elements or compounds were present in it, I probably could do so, although in many cases I would not be able to tell how much of each was present. If, however, the liquid were not of a common kind—were, say, a mixture of plant juices—and you asked me to determine of what it was composed, I would find the task extremely difficult and very likely impossible."

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[1] In connection with the experiments on lubricants cited in the footnote on p. 450 and reported in *S.A.E. Journal*, December, 1937, p. 552, for example, Mr. A. E. Burwell of the Alox Corporation, in the same issue of the journal is reported to have commented on the experiments as follows:

"As a matter of fact, in operating machines of all imaginable sorts, our company has gathered a rather large amount of evidence showing, we believe, very definitely that a proper degree of oiliness in lubricating oils of the most various kinds, contributes infallibly to the reduction of wear.

"*One of the outstanding criticisms* I would offer to Mr. Neely for his consideration *would be to increase the unit pressures in his machine, if possible, to the breaking point of the films formed. I believe that such a procedure would show much more definitely the effect of proper oiliness in less time.* In this connection he might also study the effect at high drags of various oiliness compounds on various bearing metals." [Italics not in original.]

In short, Mr. Burwell was of the opinion that, had Mr. Neely's testing procedure been modified, different results would have been obtained.

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In Bulletin No. 53, issued by the North Dakota Regulatory Department in 1938 dealing with analyses of paints and varnishes, the following statement is made regarding varnishes:

> The labeling conditions were not as satisfactory as they were in the case of paints. A large number of the varnishes failed to bear the analysis on the label. The North Dakota Varnish Law requires that all varnishes offered for sale in North Dakota show on the label the approximate composition expressed in per cent of each constituent or ingredient contained in the varnish, varnish substitute, or compound as the case may be. The law is rather inadequate, much more so than in the case of paints, for the reason that the composition of a varnish does not reveal to any great extent the quality or the physical properties and durability to be expected from a product of this nature. The quality of a varnish depends upon the manner in which it is treated, perhaps more than upon the materials used.[1]

Mr. Arthur Kallet, Director of Consumers' Union, pointed out the difficulty of determining the quantity of lead present in a product when the quantity is small. Different laboratories, testing different parts of the same sample, sometimes have obtained quite varied results.[2]

MEASUREMENT OF PERFORMANCE CRITERIA

When it is desired to determine what a product will do, as contrasted with what it is, the problem of test methods becomes very difficult, and different investigators frequently have very different ideas as to what constitutes the right method.

The real problem, of course, is to find a test method which accurately forecasts what the results in use will be.[3] Consumers are helped little if the test cannot be interpreted in terms of their own experience. If a stocking heel breaks at 40 pounds, what does this mean in terms of wear? What is the significance of the difference between a heel that stands 5,000 rubbings by the abrasive machine and one that stands only 2,500? Will the former wear 100% better than the latter? If a cooking pan is struck with hard blunt instruments in the laboratory to determine its resistance to chipping, purchasers may be misled unless the pan will show the same degree of resistance to chipping if it is dropped on the floor, if it is allowed to boil dry, or if batter is beaten in it with a metal spoon.

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[1] F. Roberts and C. S. Ladd, *Paints and Varnishes—Recent Analyses of Paints and Varnishes Accelerated Exposure Tests* (North Dakota Regulatory Department, Bulletin No. 53), p. 122.

[2] Speaking of standards for drugs, Mr. Kallet has written: "Some of the most vital drugs, however, are subject to rapid deterioration, and their purity and potency can be checked only with considerable difficulty." (Arthur Kallet, "Foods and Drugs for the Consumer," *Annals of the American Academy of Political and Social Science*, May, 1934, p. 33.)

[3] The results of Mr. Neely's tests of lubricants, for example, [see footnotes, pp. 450 and 452] could have no practical value unless interpreted in terms of what the effect of the lubricants would be if used in engines under service conditions. In this connection, Mr. G. H. B. Davis of the Esso Laboratories, Standard Oil Development Company, is reported, in the same issue of the *S.A.E. Journal*, p. 553, to have said:

"In the introduction to his paper Mr. Neely expressed the hope that his work 'would contribute to a better understanding of some of the theories of oiliness' and so on. *Considering the dissimilarity of his apparatus compared to the operating parts of automotive engines* and the questions as to whether his apparatus shows the effects of viscosity, film thickness, extreme-pressure characteristic or oiliness, I fear it is difficult to feel much nearer to a solution of the problem of oiliness and wear.

"He has emphasized clearly a point that we should always bear in mind—that all materials which may be added to oils to reduce their frictional characteristics do not necessarily reduce wear. By the same token, *extreme care must be used in drawing conclusions from tests on one particular apparatus and applying them to an entirely different test*." [Italics not in original.]

The difficulty met in deciding what test methods mean in terms of usage is illustrated by the following example. A test method by which to measure the waterproofness of fabrics has been developed and is used in various testing laboratories. The instrument adopted for this purpose consists essentially of a tower in the base of which a piece of the fabric to be tested can be clamped. Water then can be poured into the tower and the height of a column of water, or the hydrostatic pressure, necessary to cause the water to pass through the fabric can be determined, as well as the amount of water passing through and the rate of its passage. Laboratory executives using this technique are faced with such questions as: How many centimeters of water pressure correspond to a shower, to a medium rainfall, to a downpour? If only a few drops of water come through at a given pressure, what does this mean in terms of use? What allowance should be made for the time element; if at a selected pressure no water penetrates the fabric for 10 minutes, what significance does this have for users?

The production head of a company manufacturing typewriter ribbons explained how invalid a wear test on such a ribbon may be under certain conditions. If a ribbon is tested in a laboratory writing machine, it matters greatly whether the test is continued without cessation or whether rest periods are introduced after each passage of the section of the ribbon under test. If the first procedure is followed, a ribbon with a thin ink solution will prove better than one with a heavier solution. This is because the thinner solution, which easily can be obtained by use of volatile solvents, will enable the ribbon to reink itself rapidly. However, in actual service, unless use is to be constant as in the test, such a ribbon will be of little value because the ink solution will evaporate and the ribbon dry out long before the fabric is worn through.

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STEP 4: DETERMINATION OF HOW MANY AND WHICH PRODUCT UNITS ARE TO BE EXAMINED—SAMPLING

The work of testing material objects falls into either one of two kinds of procedures. In one case the objects are checked against a standard in such a way that no part of the objects are damaged or destroyed. In the other case the objects tested must be destroyed. Illustrative of the first is a test of measurement or of weight, such as the test of the size of a piston to go in an automobile engine or the weight of a connecting rod for the same engine. Tests of the second kind involve the measuring of such properties as tensile strength or capacity to resist wear. The distinction is important, for, in the tests of the first kind, every piece can, if necessary, be checked. This kind of test is commonly called inspection and is extensively employed in manufacturing. In tests of the second kind, however, it would be futile to check every piece, for in that case all would be destroyed and none would remain for economic use. In tests of the second kind, consequently, a sample must be employed as representative of the whole. Clearly, the smaller the number of destroyed specimens, the more economic and less wasteful is the procedure. Merchandise testing, consequently, tends toward the use of small samples.

The first problem which arises in the use of such samples is their selection. Not only do theory and practice require that there shall be a truly random selection, but the time elapsing between the drawing of the sample and the use of the remainder of the goods often has an important bearing upon the problem of evaluating merchandise from the consumer's point of view. The following statement covering tests of silk stockings, for example, appears in a government bulletin.[1] "The great difference in the results for the unlaundered stockings when tested three and approximately twenty days after being received from the mills was somewhat surprising. This difference is real, however, and must be attributed to some chemical or physical change in the silk." Strawberries graded at the growers' headquarters may be deserving of very different notations when they reach consumers.

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The care accorded the samples also may affect the test results. Mr. Paul Williams, Senior Marketing Specialist of the Bureau of Agricultural Economics, has said that certain soft canned fruits and vegetables can be lowered a full grade by being dropped on the floor or otherwise roughly handled. In the case of cod liver oil, the vitamin A content may be destroyed at any time by exposure to air, light, or warmth.

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After the sample has been selected and after the measurements have been obtained through the use of appropriate testing methods, the question remains, "What do the results mean as applied to the whole of which this sample was a part?" Obviously it is entirely possible in the selection of a small sample to choose by accident exceptionally good cases or exceptionally poor cases.

Statistical techniques for reducing the observed values should be employed to distinguish whether the sample employed properly conforms to an assumed or desired universe, i.e., total stock of merchandise being tested. Calculations to determine whether there is such conformity must consider both the size of the sample and its uniformity. Statistical techniques which make it possible to analyse such cases have been developed in part.[2] It is important that they be used in order that those making the tests shall not be deceived by comparisons based upon simple arithmetic averages.

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[1] Herbert F. Schiefer and Richard S. Cleveland, *Factors Affecting the Performance of Hosiery on the Hosiery-Testing Machine* (U.S. Department of Commerce, National Bureau of Standards, Research Paper RP753, reprinted from the *Journal of Research of the National Bureau of Standards*, Vol. 14, January, 1935), p. 7.

[2] See Theodore H. Brown, *The Use of Statistical Techniques in Certain Problems of Market Research* (Harvard Business School, Division of Research, Business Research Studies, No. 2, 1933) and G. U. Yule and M. G. Kendall, *An Introduction to the Theory of Statistics* (11th ed., London, Griffin, 1937), pp. 332–461.

STEP 5: MAKING THE MEASUREMENTS

The actual work of testing and evaluating may be carried on by the government, by producers, by distributors, or by independent agencies. If more than one agency is involved, uniformity of results cannot be hoped for unless criteria, sampling, and test procedure are agreed upon in detail and unless the individuals making the tests are given common training and instructions. It is not without significance that the two leading nongovernmental organizations that are engaged in rating consumers' goods not infrequently disagree, not only with manufacturers but also with each other, as to which brands of products are meritorious and which are unworthy.

Lack of agreement in product evaluations made by different department store testing bureaus is referred to in the following quotation:

> All store laboratories are working independently toward a common purpose. This procedure is wasteful in the extreme. The laboratories have almost no government, industrial, or other standards for comparison. The promotional claims made therefore are colored by the conception of the technician as to what merchandise qualities are of the most importance and one laboratory's findings may be at variance with those of another as the result of the use of a different technique in testing.[1]

Such disagreement appears inevitable when organizations operate independently. A high measure of agreement would be amazing in view of the wide range of criteria and test methods and conditions open for selection by the testing agencies. The American Standards Association has found, for example, that, in the case of cloth, conditions of temperature and humidity may make a difference of more than 10% in tensile strength. If one testing agency tests the wear of toothbrush bristles when they are wet and another tests their wear when dry, results may not agree.

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STEP 6: INFORMING CONSUMERS

After merchandise classifications have been set up, criteria selected, test methods decided upon, samples drawn, and tests actually made and their results tabulated, it then is necessary, if consumers are to benefit, to transmit information concerning the tests to them in usable form. Various proposals for doing this have either been employed or suggested.

In considering these proposals for informing consumers as to product value, one must continually bear in mind the fact that the selection of the appropriate method in any case is essentially no more than a question of technique; the vital question is not what technique to use but rather what is the significance of the information which is to be conveyed to consumers by whatever technique. One method may be better in one situation, and some other method may be more suitable under a different set of circumstances. But, whatever the method used, it is clear that its value is directly dependent upon the value of the data for whose transmission it has been selected as the appropriate form.

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[1] Jules Labarthe, Jr., "Laboratory Testing Programs," *The Bulletin of the National Retail Dry Goods Association*, September, 1937, p. 83.

It is true that whatever method is used to inform consumers, some of the preciseness of the data it is hoped to convey will be lost. Consequently, the very fact that this intermediary step is necessary between the compiling of product data and its use by consumers constitutes in itself a limitation upon programs of consumer guidance. Nevertheless, if it is possible to forecast the worth of merchandise to consumers, then it will be possible in some measure at least to convey that information to them.

TWO GENERAL METHODS FOR INFORMING CONSUMERS

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The two most commonly suggested methods for use in giving consumers formal guidance in buying are the informative label and the grade notation, and these devices will be discussed in somewhat more detail, with briefer references to various other methods.

THE INFORMATIVE LABEL

Use of the informative label raises questions as to the amount of the available information which should be given; the terms in which it should be expressed; and the agency which should be responsible for the accuracy of the information given.

It is clear that if information is given as to only a few of the product characteristics that may determine the worth of the merchandise to consumers, then the guidance will at best be partial. At worst it will lead buyers in the wrong direction by drawing their attention from inferior aspects of the product to those in which it may excel. A label stating that a material is colorfast to washing, for example, might induce purchase of that material even though it in fact could not be safely washed because of its propensity to shrink. In other words, an enumeration of particular product merits on a label may serve to conceal product failings. It is the old story of the truth but not the whole truth. On the other hand, if information is given on the label as to all important characteristics, consumers may be stalemated when they attempt to assign appropriate weights to various factors listed for competing products.

The following statement as to the information which should appear on blanket labels is quoted from a bulletin of the U.S. Department of Agriculture:[1]

> . . . In order that the consumer may select the best blanket the label should give: the length and the width in inches; the fiber content in percent; weight in number of ounces per square yard; the breaking strength of the fabric, especially filling-wise, and whether determined by the strip or grab method; and a measure of warmth, either heat transmission or air permeability or both. In wool-mixed blankets the type of yarn—whether the warp is all-cotton and the filling all-wool, a core yarn, or a blended yarn—should be stated.
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[1] Bess M. Viemont, Margaret B. Hays, and Ruth O'Brien, *Guides for Buying Sheets, Blankets, and Bath Towels* (U.S. Department of Agriculture, Farmers' Bulletin No. 1765), p. 27.

Consumers' Guide, March 28, 1938, page 12, is authority for the following statement as to what a soap label should contain:

> In order to compare values in different soaps intended for the same use the consumer should know: (1) how much the soap weighs; (2) what proportion of excess alkalies or excess fats are contained in the soap; (3) what "builders" or "extras" it contains, their purpose, and what part of the soap they comprise; (4) how much water is in the soap (a certain amount of water is necessary in every soap); (5) if it is a floating soap, how much air is in it in relation to the size and weight of the bar; and (6) the best use to which the soap can be put. Few soap labels tell these things now. They are facts for consumers to aim at getting.

Beyond the problem of what type of information the label should furnish, lies a further problem of how to express the data. One possibility is to provide the consumer with the actual test data in technical terms: the leg of this stocking can be expanded to 21½ inches, 1,000 times without a run developing; the heel can be rubbed over a leather band traveling at such and such a speed for six hours without a hole developing; there are three threads to each yarn; the threads are silk; and so on. Information as to who did the testing and how the sampling was done could be added.

It is evident, however, that not many people, even those technically trained, are fitted to interpret such technical data concerning even a few aspects of a few products. The significance of the technical data commonly must be translated into familiar terms to be of use to consumers. A label on Chatham sheets, for example, gives the thread count, 72 x 72; the tensile strength, 71 pounds warp, 72 pounds filling; the fabric weight, 4.7 ounces per yard; and the average sizing, ¾ of 1%, and then summarizes this information with the statement: "This is a heavy weight muslin for better grade household use." The data regarding a less expensive sheet are summarized thus: "This is a medium weight muslin for service use." It is not unlikely that the summary statements, indefinite as they are, help consumers more than the itemized technical data.

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The Informative Bulletin and Advertisement

These problems which are met in connection with the use of the informative label also are met when use is made of the informative bulletin or advertisement. In those cases, also, decisions must be reached as to what information to give and as to how to express it.

The North Dakota Regulatory Department, for example, from time to time publishes bulletins giving analyses made by the state chemist of various products identified by brands or other designations.[1] Bulletin No. 53 of the North Dakota Regulatory Department describes analyses of paints and varnishes and gives technical data regarding the contents of paints and the results of wear tests; simple interpretive statements in many instances accompany these technical data. Bulletin No. 54, *Lubricating Oil, Gasoline and Kerosene Inspection, Tractor Fuel*, April, 1938, as the title suggests, gives analyses of gasoline and other petroleum products. In this instance only technical data are made available. For example, the analysis of various brands of lubricating oils is given under the following table headings on page 5 of the bulletin:

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[1] Various other organizations publish informative bulletins for consumer use. Consumers' Counsel of the A.A.A., for example, distributes free a periodical called *Consumers' Guide.* Two nongovernmental organizations, Consumers' Research and Consumers Union, also publish bulletins designed to aid consumers in their buying. The work of these and other agencies devoted to helping consumers is described and discussed in an article by Louis Bader and J. P. Wernette, "Consumer Movements and Business," published in *The Journal of Marketing,* July, 1938, pp. 3–15.

Lab No.
Brand and Grade, Manufacturer or Jobber, Sample from
Gravity °A.P.I.
Flash Point °F
Fire Point °F
Viscosity in Seconds, Saybolt A.P.I.
  at 0°F
  at 100°F
  at 130°F
  at 210°F
Viscosity Index
A.S.T.M. Color No.
Four Point °F
Neutralization No.
Corrosion
Carbon Residue %
Oxidation No.

Bulletin No. 52 gives the results of analyses of food and drug products, some of which are given in tabular and technical form with an interpretive statement. For example, numerous drug products are castigated as nostrums. Failures of merchandise to meet the law regarding labeling are pointed out. Following is an example of the information given, page 34, for a brand of canned peas, the brand name of which is deleted here:

> 24947 —— Brand Fancy Extra Sifted Early Variety Peas. —— Canning Company, ——, Wis., —— Grocery, Minot. Three cans. Claim 1 lb. 4 oz., found 1 lb. 5 1/16 oz., 1 lb. 5 1/8 oz., and 1 lb. 5 3/8 oz.; head space 0.7%, 0.4%, and none; pH of liquid 6.17, 6.13, and 6.15. Condition of cans, good, lacquered. Peas not of quality to warrant statement "Fancy Extra Sifted." Percentage not No. 2 peas, 14.60%, 11.83%, and 29.36%. Two cans Grade C, one can substandard.

Bulletins of this type lend themselves to a flexible treatment of informative data and also allow a more thorough treatment than ordinarily is possible in the case of informative labels. They, of course, have the disadvantage of not being offered with goods at time of purchase.

The problem of selection of information to be given is serious in the case of the informative advertisement. Space is definitely limited and, furthermore, the advertisement has a task to perform in addition to that of giving information. Various firms, particularly in recent years, have undertaken to report in advertisements upon tests of their products. Within the limits of an advertisement, however, it is very difficult to include sufficient facts concerning the procedure and methods followed to enable the reader to arrive at a sound interpretation of the test results. Obviously it is in most cases impossible to cover all significant aspects of the product. The presentation of objective facts, no matter how accurate they are, here as elsewhere may prove confusing and misleading rather than helpful.

IMPORTANCE OF STANDARD NOMENCLATURE

One of the most essential means for increasing the usefulness of informative labels, bulletins, and advertisements is the development of a standard nomenclature descriptive of product characteristics. This is one of the goals of the American Standards Association in its work for consumers. Considerable work along this line already has been done by government and business groups. The question of who should be responsible for the accuracy of the informative statements will not be discussed here, except that it will be pointed out that, unless an adequate check is maintained on such statements, their use may work to the detriment of consumers.

It must be repeated that the value of any informative statements depends primarily upon the information which is given, and that a lack in that respect cannot be compensated for by any technique of presentation. The worth of the label must depend upon the product characteristics selected for coverage, the testing or checking methods employed, and the interpretation that is made of the test results.

THE QUALITY GRADE NOTATION

The quality grade notation is another method commonly recommended for use in informing consumers as to product values. The summing up of the merits of a product under a single grade notation, unless only one aspect of the product is judged to be of particular significance to consumers, involves not only selection of criteria but also the application of a weighting scale to the criteria selected.

In the case of canned peas, for example, the product in order to be classed as Grade A under the standards set by the Department of Agriculture must score not less than 90 points, and to be classed as Grade B must score not less than 75 points, when graded on the following scoring system.[1]

	Points
I. Clearness of liquor	15
II. Absence of defects	15
III. Uniformity of size and color	10
IV. Tenderness and maturity	35
V. Flavor	25
Total score	100

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[1] U.S. Department of Agriculture, Bureau of Agricultural Economics, Service and Regulatory Announcements No. 140, *United States Standards for Grades of Canned Peas.* "Tenderness and maturity," the most heavily weighted criterion, is defined as follows:

"IV. Tenderness and Maturity

"*A.* To receive a rating within the highest group, 32 to 35 points, for this factor, the peas must be very young and very tender.

"*B.* If the peas are less tender than those of the first group, a score within the range of 28 to 31 points may be allowed.

"*C.* If the peas have somewhat tough skins and are somewhat mealy or starchy, but require less than 2 pounds of pressure to crush the cotyledons to one fourth their original thickness, from 25 to 27 points may be allowed. Peas that fall in this classification shall not be graded above U.S. Grade C, or standard, regardless of the total score for the product.

"*D.* If 10 per cent by count of the peas are so mature that they require a crushing force of 2 pounds or more to crush the cotyledons to one fourth their original thickness, or the skins are very tough, from 0 to 24 points may be allowed."

In the case of canned spinach, on the other hand, the Department of Agriculture's standards allow flavor a maximum of only 15 points instead of 25, and allow absence of defects 25 points rather than 15 as with the peas.

Obviously, if the characteristics selected for weighting or the weights themselves are out of line with users' conceptions of value, the final grade notations in so far as they are intended to indicate merit also will be out of line. A dress which was graded 90 for merit because tests seemed to indicate that it would wear well [credit 50 points] and that the material of which it was made would not shrink [credit 30 points] or fade if washed [credit 20 points] would not be worth that rating necessarily if what the buyer desired was a highly styled dress to be used on a few occasions and to be dry cleaned not washed.

Instead of presenting the consumer a valuation of a product summarized in a single grade notation, it is possible to give him separate grade notations for the various product characteristics judged to be of importance. Logically this plan has much to commend it as compared with the plan of a single rating based on a weighted average for all the important characteristics. It approaches in its effect the informative label. Like the informative label it has the obvious advantage of avoiding to some extent the necessity for making arbitrary assumptions as to the relative importance of various factors to consumers. But, also like the informative label, it may prove confusing to consumers if its application is extended to too many characteristics. R. H. Macy & Company, Inc., for example, had reason to believe that a separate rating of only two characteristics was confusing to consumers in the case of blankets.

Macy's for some years gave blankets A, B, C ratings separately for warmth and for durability, thus leaving consumers to assign their own weights to the two factors. The basis for determining the warmth ratings is interesting. The company developed a thermal transmission apparatus to test the relative warmth of materials. It then selected Alaska sealskin as a standard with which to compare blankets. If a blanket was found by the test method used to be 95% as warm as Alaska seal, it was marked Grade A for warmth; if it was 90% to 95% as warm, it was marked Grade B; and if it was 85% to 90% as warm, it was marked Grade C. Durability likewise was measured by laboratory test and grades assigned on that basis. The company, however, finally discontinued this plan of labeling blankets in the belief that the grade ratings were misleading rather than helpful to consumers.

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Although the A, B, C ratings provided the possible advantage of showing the relative position of different blankets in terms of the test procedure, consumers apparently had no experience upon which to judge such ratings. While the phrase "warm as a polar bear" might appear fantastical, after all, a grade notation, whether given as "A" or whether interpreted as meaning 90% to 95% as warm as an Alaskan seal, would appear to offer consumers little more help in evaluation. The most they probably could gather from such notations would be that a blanket which was 90% to 95% as warm as an Alaskan sealskin would be *somewhat* warmer than a blanket which was 85% to 90% as warm as the sealskin. Moreover, the department store's customers may well have been confused trying to estimate whether a blanket which was only 85% to 90% as warm as an Alaskan sealskin, but which had an A rating for durability, not in itself interpreted in terms of usage, was more or less desirable or worth more or less than one which was 95% as warm as an Alaskan sealskin but which had a B rating for durability.

The real meaning of grade designations clearly is difficult for consumers to comprehend in many cases. It would be possible, of course, to supply them with descriptions of the grade standards. In many instances, however, they scarcely could be expected to translate such descriptions into terms of probable satisfaction in use. When a subjective factor, such as flavor, constitutes one of the criteria, furthermore, no definition can be devised which will convey accurately what is meant. Familiarity with the real significance of grade notations probably could be reached in the case of most merchandise only through use of goods so graded. The importance of adequate checking of grade notations for accuracy and consistency is of course clear.

A grading scale, it may be concluded, can be worked out for any product and, in most cases, this can be done on a basis which will allow interchangeable results by persons trained to do the grading. This is true even of so intangible a property as flavor. The real question, however, is not whether it is possible to grade merchandise but, rather, what can the grade notations be expected to mean in terms of consumer guidance.

THE QUALITY STANDARD[1]

Informative statements or labels to the effect that goods are guaranteed to meet standards or specifications established by some specified agency may have advantages or disadvantages as compared with a grading plan so far as administration is concerned. Their effect in giving information to consumers, however, is very much the same.

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[1] "If the contacts which the National Bureau of Standards has had with consumer groups may be used as a fair criterion, the attitude of consumers regarding what would be most helpful to them in their purchases has changed during recent years. Formerly these consumers were urging that lists of products be established with the various brands of goods in each list arranged in order of excellence. They wanted to know which was the best product. This viewpoint now seems to be changing to one that visualizes the need for standards of quality. In other words, the ultimate consumer is now beginning to see that his requirements can best be met by classifying the products in a particular group into grades, each grade standing for specific requirements as to quality. To meet this need consumer specifications with nationally recognized standing are necessary.

"Contract buyers, those who purchase large quantities of certain commodities on definite written contracts, can set forth their requirements in the form of specifications submitted for competitive bidding and are in position to tell the manufacturers just what they want and to determine by means of tests whether the commodities delivered comply with the specification requirements. The essential features of this procedure become available also to over-the-counter buyers through the labeling plan. . . .

"The ultimate consumer is not familiar with specifications, and it is necessary that help be obtained from responsible consumer groups in order to distinguish between specifications which give the proper protection and those which do not. A real danger to the whole movement lies in guarantees based on specifications which are misleading and meaningless. Nationally recognized specifications that have withstood the test of service should be used whenever possible."

Source: *Services of the National Bureau of Standards to the Consumer* (U.S. Department of Commerce, National Bureau of Standards), pp. 3–4.

The problems involved in developing standard specifications are essentially no different from those involved in setting up grade standards. In both cases decisions must be reached as to product classification, criteria for judging product worth, and test procedure. And, as in the case of grades, a guarantee, no matter how reliable, that a piece of merchandise meets a specified standard is of no value as a guide to purchase unless the standard is drawn to correspond with the buyer's needs. For example, a specification for government needs may be entirely inappropriate to household needs. "It is sometimes suggested that consumers might well use, as a basis for their buying, the Federal specifications set up by the Federal Specifications Executive Committee. However, Government specifications are not always adaptable for use in personal or household buying. They are minimum specifications for articles needed for particular uses in Government organizations, and are not necessarily suitable for any other purpose."[1] Obviously, in some instances, Government specifications may likewise fit the needs of the householder.

A label guaranteeing goods to meet a certain specification could include a description of that specification, just as grade notations can be accompanied by descriptions of grade standards. Specifications and standards, however, usually are rather long and technical, and it is unlikely that they could convey much to most consumers. The *Federal Specification for Blankets: Cotton, and Cotton-Warp and Wool-Filling*,[2] for example, reads [in part] as follows:

. . . .

E. Detail Requirements

> *E*-1. *Color and Patterns.* The blanket shall be bleached, dyed, or patterned as specified. The patterns shall be selected from the manufacturer's patterns. Insignia shall be stenciled or woven as specified in the invitation for bids. The color shall show good fastness to crocking and light, and good fastness to fresh and salt water.
>
> *E*-2. *Size.* The blankets shall be furnished in the size given in Table 1, as specified in the invitation to bid. Tolerance shall be as shown.
>
> *E*-3. *Weight.* The weight per blanket shall be as given in Table 1.
>
> *E*-4. *Weave.* The material shall have a filling backed weave with one warp and two fillings.
>
> *E*-5. The constructions shall be as shown in Table 1.
>
> *E*-6. *Fiber Content.*
>
> *E*-6*a*. Type I shall be all cotton.
>
> *E*-6*b*. Type II shall contain at least 80 percent wool by weight.
>
> *E*-7. *Shrinkage.* The blankets shall not shrink more than 10 percent either way.
>
> *E*-8. *Breaking Strength.* The minimum breaking strength for the cotton-warp wool-filling blanket shall be 38 pounds in the warp and 36 in the filling.
>
> *E*-9. Type II, cotton-warp, wool-filling blanket shall be well fulled and shall have a maximum of napping consistent with other requirements.

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[1] Ruth O'Brien and Medora M. Ward, *Present Guides for Household Buying* (U.S. Department of Commerce, Miscellaneous Publication No. 193, Washington, D.C., U.S. Government Printing Office, January, 1936), p. 3.

[2] *Federal Specification for Blankets; Cotton, and Cotton-Warp and Wool-Filling* (Federal Standard Stock Catalogue, January 9, 1934), Section IV, Part 5, pp. 1–3.

TABLE I

FEDERAL SPECIFICATIONS FOR CONSTRUCTIONS OF BLANKETS

Size		Tolerance (inches)	Nominal Weight per Blanket (pounds)	Minimum Weight Acceptable per Blanket (pounds)	Thread Count	
Width (inches)	Length (inches)				Warp (minimum)	Filling (total)
I. All Cotton						
60	80	±2	3.2	3.04	40	36
66	80	±2	3.5	3.33	40	36
72	84	±2	4.0	3.80	40	36
54	84	±2	3.0	2.85	40	36
66	84	±2	3.5	3.33	40	36
II. Cotton-Warp, Wool-Filling						
60	80	±2	3.4	3.33	52	40
66	80	±2	3.8	3.61	52	40
72	84	±2	4.3	4.09	52	40
54	84	±2	3.2 or 4.5 *	3.04 or 4.28 *	52	40
66	84	±2	4.0 or 5.2 *	3.80 or 4.94 *	52	40

* As specified.

In those areas in which unrestricted production represents a potential danger to the health and safety of the public, various minimum standards already have been developed and their observance made obligatory. There can be no lack of agreement as to the need for mandatory minimum protective standards of this type although there may be room for differences of opinion as to what the minimums should be. When a standard becomes more than a minimum requirement for full protection of health and safety, however, and is intended to be a statement of worth, then insistence that all production should be in accordance with it clearly would presuppose a basic change in our social structure.

THE BRAND OR TRADE-MARK

It must not be overlooked that the brand or trade-mark has a long history as a means for guiding consumers in their selections of merchandise. Such marks originally, in the days of the craftsman's guilds, were compulsory indications of origin, the purpose of which was to facilitate the tracing of false or defective wares to the guilty parties and to prevent craftsmen living outside a guild area from selling their wares within its boundaries.[1] Schechter remarks that:[2] "In the course of time in certain trades these police marks or liability marks gradually became, as we shall see, asset marks, that is to say, they became valuable symbols of individual good-will."

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[1] Frank I. Schechter, *Historical Foundations of the Law Relating to Trade-Marks* (New York, Columbia University Press, 1925).

[2] *Ibid.*, p. 47.

And, speaking of trade-marks as of the present time, Schechter says:[1]

"As stated above, from the standpoint of realities the consumer does not regard the trade-mark as an indication of origin but rather as a guaranty that the goods purchased under the trade-mark will have the same meritorious qualities as those previously noted by him in his purchases of other goods bearing the same mark."

It is not within the scope of this paper to inquire into the use that has been made of the brand in modern times or to do more than point out certain inherent advantages and disadvantages of this technique for informing consumers of product qualities.

An obvious disadvantage is the fact that the brand or trade-mark is affixed by an interested party.[2] This fact of interest, however, can equally well be cited as an advantage of this form of consumer guidance inasmuch as the owner customarily depends for his success upon the continuing favor which his mark finds with buyers and inasmuch as, furthermore, he is in the most advantageous position for knowing and controlling the worth of his goods.

The brand, like the simple grade notation, can be criticized for failing to provide consumers with specific facts upon which to arrive at rational conclusions; the brand must be regarded, however, as operating in conjunction with advertisements and other sales literature, which may be used to provide factual data.

Perhaps the most serious weakness of the brand as an aid to consumers is that, since it is an individual mark, it does nothing to group or classify goods so as to reduce the number of possible choices consumers must face. This weakness applies also to the informative label, to some extent, but the grade or specification notation avoids it. That is, if all goods of a certain class are divided into three grades, then, if it be assumed that the goods in a single grade group are essentially the same, the consumer's field of selection is reduced from some large number to three.

By the same token, on the other hand, the brand can indicate finer points of differentiation than can be indicated by grade or specification groupings. Not all goods falling in the same grade group or meeting the same specification will be exactly or perhaps even very closely alike. Goods bearing the same brand, however, will, or at least can, be for all practical purposes identical. In the field of repeat purchases, consequently, the brand in a sense can give the most complete guidance possible. It can assure users that a second purchase of a given branded article will be to all intents and purposes the same as the first purchase.

Brand and grade notations, it is important to remember, do not need to be mutually exclusive devices for consumer guidance.

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[1] *Ibid.*, p. 150.

[2] As a practical matter, it is likely that under any widespread program of consumer guidance, informative labels, guarantees of compliance with specifications, and even grade ratings would have to be provided by the producers. The advantage of these devices in this connection is that the commitments would be specifically stated so that independent checks could be made by outside agencies.

General Educational Information

The dissemination of general educational information as to products, their uses, and their care is another means for guiding consumption. There is a great deal of basic information concerning merchandise that consumers should find it helpful to know: the general characteristics of different fabrics, what may reasonably be required of them, the care they will need; what it probably will cost to operate a mechanical refrigerator; what the nutritive values of various types of foods are; what in general constitutes a balanced diet. Such information, which is the fruit of experience and basic research, helps consumers not so much to choose between different brands of the same articles as to select the classes of articles most appropriate for their purposes. Perhaps the greatest weakness of consumers at the present time is their lack of curiosity about, and their lack of knowledge of, such basic facts.

Here, as in the case of the other methods of informing consumers of product values, the importance of accuracy must be stressed. Misinformation is worse than no information at all. In a recent magazine article, the following statements were made as to how one could distinguish a good silk stocking from a poor one.[1]

"Full-fashioned stockings are knit flat, starting at the top or welt with the required number of stitches according to the gauge of the machine, and narrowing automatically by dropping out needles at the knee, calf, and ankle. Where these narrowings occur there will be tiny dots, called fashion points, on both sides of the back seam."

. . . .

Summary

The purpose of this final chapter has been to suggest fruitful objectives for programs designed to aid consumers. Objectives in conflict with the fundamental principles of our social and economic order have not been considered. And objectives incapable of realization within that order have been rejected.

The numerous considerations which limit the usefulness of merchandise evaluations have been set forth earlier: the variegated nature of consumers, with their wide differences in purchasing power, interests, tastes, and skills; the peculiar nature of merchandise, with its multiple, ever shifting, and often conflicting characteristics; and the special problems inherent in the process of evaluation—determination of meaningful product groupings, selection of appropriate criteria for judging worth, designing of test methods that will measure the criteria in terms that have meaning from the point of view of actual service, determination of how many and which units to examine, and translation of the test results into a language or a form that will be correctly interpreted by consumers. It has been concluded that the guidance which can be given consumers in making their choices of merchandise is of a decidedly incomplete character. Blanket ratings or appraisals can be used to separate very good from very poor merchandise, but ordinarily they cannot be depended upon to indicate finer distinctions in probable product satisfactoriness to consumers. Factual information concerning products, although it may be enlightening as to specific product characteristics, seldom can be complete without also being confusing.

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[1] Margaret Dana, "Silk Stockings and How to Know Them," *Atlantic Monthly*, April, 1938, p. 521.

Nevertheless, within the limitations imposed by the nature of the situation, there are various important things that can be done for consumers: to improve merchandise; to aid consumers in making their choices; and to encourage the proper utilization of goods purchased. These things, which it is believed constitute proper objectives for programs of consumer aid, are summarized in the following paragraphs. It is entirely possible that there are worth-while objectives not included in this list; in any event, whatever objectives are set up must, if they are to be capable of realization, recognize the limitations outlined in this study.

Objective 1. Development in certain areas of identifying classifications of goods; and promotion of their common and honest use by manufacturers, distributors, and consumers.

Certain types of goods, notably those for which producers' standards have been developed, lend themselves to classifications which can be useful in guiding the choices of consumers. These class groupings may be identified by standard terms indicating compliance with standard specifications, by grade notations, or otherwise. The value of the class groupings to consumers will depend primarily not upon any objective evaluation implied by the grade or other standards observed. The principal value will arise, rather, from the indication given that the goods are of a definite type, and the extent of the help received by consumers will depend upon their ability to familiarize themselves with the meaning of the identifying notations or descriptions. To be useful, such identifying classifications obviously would have to be honestly, as well as widely, employed.

Objective 2. Development of classifications aimed at simplification.

It is evident that the fewer the classes into which goods reasonably can be grouped, the simpler will be the purchaser's task of selection. And there are instances in which the number of classes of consumers' goods can be reduced to advantage, not by moving the lines marking class divisions farther apart, but by arbitrarily limiting the number of varieties to be classified. Just as there are in industry instances in which the economies and convenience resulting from standardization offset whatever is lost in the way of product suitability, so also there are similar instances in the case of consumers' goods. There is no inherent reason, for example, why the quart and the pint are the best measures for milk or why milk should be sold to consumers in those units only. The advantage of having the number of possible measuring units reduced, however, outweighs the disadvantage of not always being able to get milk in the exact quantity that may be needed for the day.

There are many instances of this kind: number of classes and sizes of beds, sheets, and blankets; number of shapes and sizes of containers; fill of containers; size groupings of various types of clothing; and so on. The reduction in the number of product classes which follows from this process of limiting varieties, usually referred to as simplification, reduces confusion in buying. Any sacrifice that may be entailed in cases of this kind in respect to product suitability is more than compensated for by greater simplicity and perhaps greater economy in buying. Considerable progress in simplification already has come about through cooperative action by trade and government groups. It is not always easy in cases of this kind to arrive at sound decisions as to variety limitations; usually decisions, as with decisions concerning other industrial standards, are reached only after a long period of investigation and mutual discussion by interested parties. Unless the standards adopted are in accord with sound manufacturing practices, convenience in selection may be won at the expense of economy.

Objective 3. Development of a dictionary of understandable terms and definitions covering significant product qualities; and promotion of their common and honest use by manufacturers, distributors, and consumers in describing merchandise.

Achievement of this objective would do much to remove confusion from buying and to reduce both intentional and unintentional misrepresentation. There are, of course, many important product qualities incapable of being reduced to definitions that can have meaning to consumers; even the simplest terms no doubt will be misunderstood by some. Nevertheless, the use of standard nomenclature to whatever extent is feasible introduces a certain discipline and order into the sales picture that is beneficial both to buyers and to sellers. Not only does use of standard terms in product descriptions serve to simplify product selection, but it also provides a clearly defined basis for checking the honesty of the claims made.

Objective 4. Prevention of the manufacture and sale of harmful and fraudulent merchandise.

It is clear that consumers should have this very important protection. They should be able to make their selections of merchandise with the assurance that, regardless of whether they are obtaining the best goods for their expenditures, they are safe from injury and outright fraud. It is in this area that mandatory standards are essential. Whatever the limitations may be upon testing procedures designed to compare sound merchandise, such procedures can be accepted as providing a fundamental and for the most part adequate basis for the detection of injurious and misrepresented goods. It already has been pointed out that the development of standard definitions to be used in product descriptions provides a helpful basis for the detection of misrepresentation and fraud.

Objective 5. Formulation and dissemination for consumer use of fundamental factual data as to the characteristics of the various types of goods, their uses, and their care.

This is an educational task. Its adequate realization should lead to a more intelligent approach to the problems of merchandise selection on the part of consumers. Not only would they be helped to allocate their incomes wisely among the different types of available merchandise and to obtain the maximum satisfaction from the goods they purchase, but they also would be provided with a sound defense against false and exaggerated sales claims.

Objective 6. Support of basic product research aimed at product improvement rather than at product evaluation.

No matter how clearly the merits of merchandise were indicated for consumers, satisfaction would not follow use unless the merchandise itself was satisfactory. Choice obviously is limited by what is available. In our economy, as we have seen, the responsibility for merchandise experimentation rests largely upon private enterprise, although valuable assistance is received from government, academic institutions, and other agencies that engage in merchandise and related research. It is here that the merchandise test finds its most important use.

The need for laboratory experimentation to be supplemented by use of products under actual service conditions must not be overlooked. In other words, if consumers are to have the advantages of improvements in products, it is necessary for them to cooperate in the experimental work by using the goods offered. The cheerful cooperation extended by consumers in the development of the modern motorcar from its humble beginnings is one of the most interesting examples of this kind. While experimentation is bound to result in some failures, the wastes involved should be held within reasonable limits.

Objective 7. Furtherance of all movements that tend toward improvement of business management and growth of pride in integrity in business dealings.

This final objective has not been mentioned explicitly heretofore although its importance has been implicit throughout the entire discussion. The ultimate dependence of buyers upon the integrity of those who supply them with merchandise is a conclusion that cannot be escaped no matter how unsatisfactory it may seem to some to be.

As used here, integrity refers not alone to honesty and well-meaningness, although certainly it does include those qualities. In addition it entails an intelligent alertness to, and a skillful handling of, responsibilities. A retailer who unwittingly permits injurious goods to be sold in his store is lacking in integrity if, by exercising reasonable care, he could have discovered their nature and prevented their purchase. The producer who through lack of attention to the details of management, or lack of reasonable competence, manufactures a product that is less sound than it might otherwise have been is lacking in integrity. So likewise is the producer or distributor who, whether by reason of greed or of inefficiency, overprices his goods. In the long run manifestations of lack of integrity in the management of business have a tendency to redound to the disadvantage of the business concerned. It is this fact that commonly is looked to for the protection of the public. There is no reason, however, why standards of integrity in business, that is, of honest, sound, and constructive management, cannot be improved by training and through the evolution of professional consciousness and pride on the part of business executives. Perhaps the most important achievement of the consumer movement will be found to arise from its effect in awakening producers and distributors to a sense of their responsibilities.

The producer, if that term may be applied to the more or less constant group of individuals responsible for the production of a given item, knows a great deal and determines a great deal about his product that cannot be reduced to words or made the basis for testing. In the case of many types of goods, for one thing, the points at which the goods might fail are so numerous that practical considerations alone make it impossible for the buyer to consider them all. A truck or automobile provides an excellent example of this. Suppose it is decided to cut an extra notch in a structural part in order to avoid some more costly method of making a necessary connection. The added notch may have the effect of weakening the part in such manner that, under some unusual but possible type of strain, it will give way. What buyer will foresee or allow for this? Who will count and measure the notches? Or, if this is done, who can judge the significance of this detail? What are the chances that a performance test will provide the identical type of strain that the part cannot withstand? Yet the vehicle will be less sound than it otherwise would have been, and the producer, and only the producer, will be in a position to know this. Almost any producer has numerous opportunities for cutting corners in ways impossible of outright detection no matter what policy is pursued as to specifications and tests. He may save on inspections; he may pass a few items here and there that might better be rejected. True, in the long run his product is likely to acquire an unsavory reputation, though users may be at a loss to know why they do not care for it.

Employee relations represent another aspect of producer responsibility. Relations may be good and the employees may take pride in their workmanship, or relations may be strained and the employees may merely live up to the letter of the demands made upon them. The effects of the presence or absence of pride in workmanship upon the goods produced often are incapable of definite measurement; nevertheless the effects may be real.

The distributor likewise is in an advantageous position, through his contacts with the trade and his familiarity with merchandise, for judging product soundness. Although he cannot say which of two sound articles is the better, he should be able to sift out the worthless, the unsound, and the possibly harmful. He, like the producer, has many opportunities for cutting corners in ways impossible of detection or of prevention.

These and many similar considerations enter into the question of the vendor's integrity, and it is partly for these reasons that industrial buyers set store by the seller's reputation and their previous experience in using his products.

In the last analysis it is upon the integrity of producers and distributors that buyers must rely. No quantity of laws and no amount of supervision can suffice for the production of sound goods, or for the selection of sound goods by distributors, if the producers have no interest in making their goods sound and if the distributors have no interest in offering sound merchandise. No amount of specifications, testing, and grading can definitely assure the soundness of merchandise unless there is a presumption of integrity behind it.

SOME NOTES ON THE CONSUMER MOVEMENT[1]

BY J. PHILIP WERNETTE

In the 1930's there was, in the United States, a very marked development of interest in the consumer and her problems. This interest was a product of social and economic forces which had been at work over a long period; but by 1940 the number and extent of organizations, activities, proposals, beliefs, and plans which concerned themselves with the consumer reached such proportions that the term "Consumer Movement" came to have a definitely recognized meaning, which could be described roughly as follows:

Broadly, the Consumer Movement seeks to make the consumer a wiser buyer and user of the products which she acquires in her capacity as a consumer. Essentially the purpose is to raise the standard of living of the consumer by giving her a clear perception of her wants and needs and by furnishing her with information which will help her to satisfy them. This movement is a phenomenon of the modern economy characterized by widespread and detailed division of labor and the accompanying necessary exchange of goods and services through the mechanisms of the market place.

The frontier family was typically a producing unit. The housewife prepared the food for the family, she made their clothing, and she or her husband personally made any necessary repairs or alterations in the family dwelling. There were problems for the frontier family; but they were problems connected with

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Source: Malcolm P. McNair, Edmund P. Learned, and Stanley F. Teele, ***Problems in Merchandise Distribution*** (New York, McGraw-Hill, 1942), pp. 79–89.

[1] Much of the material in this note, particularly the list of milestones, has been adapted from a report, *Labelling the Consumer Movement*, prepared by Werner K. Gabler for the American Retail Federation (published by the Federation in Washington, 1939). The following causes are discussed in some detail: the change from a rapidly expanding to a more stable economic system, the effect of the depression on the psychology of the American people, the change from a producer to an exchange economy, technological progress, the effect of modern marketing methods on the consumer, and increased interest in economic problems on the part of the American people.

deciding what to produce, how to produce it, and the like. There were obviously no problems related to fraud, deceit, advertising, and high-pressure salesmanship. Once the division of labor had been established, however, the real income in any family group was not literally what the family produced but what it succeeded in getting in exchange for its output; the forethought for family needs once put into producing was transferred to buying.

In the city family unit today there is relatively less production. Much clothing is bought ready-made. Food, to a great extent, is bought already prepared or very nearly so. Meals frequently are eaten in restaurants. Laundry for many families is done by commercial establishments. In apartments even minor repairs are made by the landlord. Producing is specialized and commercialized. Necessarily, therefore, the importance of buying has greatly increased. How high a standard of living can be procured with a given income depends not on how good a producer the housewife is but on how good a buyer.

American industry has produced for the home a vast array of labor-saving appliances and an immense variety of new articles which make life agreeable. But the skill of American industry in developing these products has advanced more rapidly than the knowledge of the consumer in judging and using them. Today the housewife employs a great number of highly complicated electrical appliances, for instance—irons, refrigerators, mixers, vacuum cleaners, washing machines. For information on quality and price the housewife has to rely primarily on commercial resources. She has slight independent means of knowing whether a given product is a good value, whether it is genuinely suited to her needs, and how it compares with an apparently similar offering of some other manufacturer. She frequently makes her purchases on the basis of emotional or price appeal.

In purchasing and taking care of textiles, the housewife is similarly confused. When all fabrics were constructed from the four natural fibres—wool, cotton, linen, and silk—there was perhaps no great need for consumer protection; but now that a large number of synthetic fibres have been developed and are used alone or in combination with natural fibres, the consumer no longer is able to recognize the content of a particular fabric, she often cannot distinguish differences in quality, and she does not know what care to give the material in order to obtain the best service.

It was after the First World War that this greatly altered nature of the consumption economy began to make its consequences felt. The 1920's were a period of intense marketing activity, attended by much so-called "high-pressure" advertising and selling, during which the increased productivity of more highly specialized labor lifted the standard of living to levels never before achieved. But in spite of the material well-being of that period, there was growing uneasiness on the part of many who interested themselves in the problems of consumer welfare.

The year 1927 saw the publication of *Your Money's Worth*, the first of a series of "debunking" books attacking advertised merchandise. The authors, Stuart Chase and F. J. Schlink, discussed adulteration in foods and drugs, the large profits said to have been made by packaging simple products and giving them fanciful names,[1] and the false or extravagant claims alleged to characterize much advertising. The book achieved wide circulation. In 1927 also, F. J. Schlink, one of the authors of *Your Money's Worth*, formed a club which later became Consumers' Research, Inc. This organization undertook to test nationally advertised products from the standpoint of the consumer and to assign ratings. The reports of Consumers' Research were available on a subscription basis. Within a brief period the number of subscribers was said to have reached 60,000.

Next came the depression years of the 1930's bringing widespread unemployment, insecurity of income, general disillusionment, and a marked tendency to make business a scapegoat. In such soil the seeds of consumer discontent germinated rapidly; and the Consumer Movement, as an economic force to be reckoned with, quickly became a flourishing growth.

As a matter of fact, however, the interest in consumer problems goes farther back in the history of the United States than is implied in this brief account of the sudden growth in the 1930's. The earlier developments and the rapid acceleration of activities to further the well-being of consumers are indicated, in some degree, by the following list of milestones.

1845	First consumer cooperatives appeared in the United States.
1860	Grange movement began. It adopted the consumer cooperative idea.
1890	Sherman Antitrust Act was passed. This was intended to furnish some protection to consumers by forbidding monopolies, combinations, or conspiracies in restraint of trade.
1906	Federal Food and Drug Law was enacted, providing some protection for the consumer against poisonous drugs and foods.
1908	American Home Economics Association was formed. Major emphasis at this time was on better use of purchased products and on better homemaking.
1912	*Good Housekeeping* certification service was established. Sears, Roebuck and Company set up a laboratory to test part of its merchandise.
1914	Federal Trade Commission Act was passed. The Federal Trade Commission was designed originally to protect manufacturers and tradesmen against unfair competition, but its activities tended by indirection to protect consumers.
	Clayton Act was passed. It expanded the provisions of the Sherman Antitrust Act and specifically defined certain unfair practices.
1919	American Home Economics Association established Standards Committee of Textile Division to sponsor the research required to set up minimum standards for textiles sold at retail and to promote consumer education and use of standards.
1923	Bureau of Home Economics was organized within the U.S. Department of Agriculture to carry on research and education in problems of consumption.
1925	American Gas Association began the work of providing standards for gas appliances.
1927	First full year in which the Federal Government offered facilities for grading meats.
	R. H. Macy & Co., Inc., established a Bureau of Standards to test merchandise offered by Macy's. In the ensuing few years several other department stores set up testing laboratories. And in 1928 the National Retail Dry Goods Association established the Better Fabrics Testing Bureau, the facilities of which were made widely available for use by department stores, manufacturers, and others.

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[1] Illustrative of this point are Appendices *A* and *B*.

Your Money's Worth, by Stuart Chase and F. J. Schlink, appeared. It achieved wide circulation.[1]

1929 Consumers' Research, Inc., was formally organized, largely as a result of the success of *Your Money's Worth.*

American Home Economics Association became affiliated with American Standards Association, which, since its founding in 1918, had confined its work exclusively to standards for industrial products.

1933 Consumers' Advisory Board was set up under the National Industrial Recovery Act. Thus, for the first time, the consumer was recognized as a partner in formulating the economic policies of the country. The Consumers' Advisory Board sought to protect consumer interests during the drafting of the codes of fair competition for the country's various industries. Its Committee on Consumer Standards advocated the formulation and greater use of standards on consumer merchandise.

Consumer's Counsel Division was set up under the Agricultural Adjustment Act to represent and protect consumers in the administration of the Act. As one of its undertakings, it published a biweekly *Consumers' Guide.*

1934 Consumers' Division of the National Emergency Council began functioning as a national clearing house for consumer information. Its program, as described in its publication *Consumer Notes*, was (1) to coordinate the work of the various agencies of the Federal Government working in the field of consumer problems, (2) to provide a link between government agencies and consumers themselves, and (3) to help in every way the efforts of local consumer groups to translate a common viewpoint into terms of their local situation.

1935 On July 30, by Presidential executive order, a Consumers' Division was created within the National Recovery Administration. This division assumed the functions previously performed by the Consumers' Advisory Board of the NRA and the Consumers' Division of the NEC.

When the National Industrial Recovery Act was declared unconstitutional, consumer activities were shifted to the Department of Labor as the Consumers' Project. Subsequently development of the program was taken over, as the Consumer Standards Project, by the Consumers' Counsel Division of the AAA. Work on this project was limited to research and education. Activities included, among others, collection of data on laws, regulations, trade practice rules, and commercial standards in use to describe the quality and form of consumer goods; a study of laws, and the administration of the laws, relating to weights and measures; and a study of the relation of grades of meat to the palatability of meats.

Consumers Union was established by some former officers and employees of Consumers' Research, Inc. By 1942 the membership was reported to be in the vicinity of 50,000.

1936 Marquis Child's *Sweden, The Middle Way* was published and became a best seller. It considerably stimulated public interest in consumer cooperatives.

Edward A. Filene, of Boston, set up the Consumer Distribution Corporation, a group designed to promote the organization and management of consumer cooperatives in the United States.

1936 American Standards Association organized an Advisory Committee on Ultimate

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[1] Numerous other "debunking" books appeared within the next few years, including the following:

100,000,000 Guinea Pigs: Dangers in Everyday Foods, Drugs and Cosmetics by Arthur Kallet and F. J. Schlink (New York, Vanguard, 1933).

Skin Deep, The Truth about Beauty Aids—Safe and Harmful by M. C. Phillips (New York, Vanguard, 1934).

Our Master's Voice: Advertising, James Rorty (New York, John Day, 1934).

Eat, Drink, and Be Wary by F. J. Schlink (New York, Covici, 1935).

The Popular Practice of Fraud by T. Swann Harding (New York, Longmans, 1935).

Guinea Pigs No More by J. B. Matthews (New York, Covici, 1936).

Consumer Goods as the first step toward the establishment of standards of durability and serviceability for goods sold at retail.

A plank calling for consumer protection was incorporated in the platform adopted by the national convention of the Democratic Party.

The Administration sent a commission to Europe to study consumer cooperatives. Its findings were published in 1937 under the title *Report of the Inquiry on Cooperative Enterprise in Europe* (Washington, D.C., U.S. Government Printing Office).

1937 Federal Trade Commission promulgated rules requiring disclosure of rayon content of fabrics. Rules subsequently issued required accurate labeling of silk products, of textiles containing mixed fibres, and of furs and garments employing fur.

Consumers' Counsel of the Bituminous Coal Commission was established by Congress, the first consumer body to be set up by Congressional action. (The Coal Commission and the Consumers' Counsel were abolished by the second reorganization plan, of May 9, 1939; and their functions were transferred to the Department of the Interior.)

National Consumer-Retailer Relations Council was formed, the first body established by consumers and retailers on an equal basis. Its membership, consisting primarily of national associations of consumers and national associations of retailers included the General Federation of Women's Clubs, the American Association of University Women, and the American Home Economics Association, on the consumer side; and the National Retail Dry Goods Association, the American Retail Federation, and the National Association of Better Business Bureaus, on the retail side. The stated purposes were (1) to stimulate interest on the part of consumers, distributors, manufacturers and the public in the value and use of adequate standards for consumer goods, (2) to promote the use of uniform terminology in describing consumer goods and services, (3) to promote the use of informative labeling, (4) to promote the use of truthful and factual information in advertising, (5) to promote informative salesmanship, and (6) to develop and promote the use of suggested codes of ethics for both retailers and consumers.

1938 Institute for Consumer Education, an independent agency, established at Stephens College, Columbia, Mo., under the auspices of the Alfred P. Sloan Foundation. The program of the Institute included research, study, and education.

Annual conferences on consumer education, drawing representatives from all over the country, were inaugurated in 1939.

Michigan set up the first state consumer department.

Congress passed the Wheeler-Lea amendments to the Federal Trade Commission Act, enlarging the power of the Federal Trade Commission to protect the consumer.

Congress passed the Federal Food, Drug, and Cosmetic Act, which gave better protection than the Food and Drug Act of 1906.

General Federation of Women's Clubs established a department of consumer education.

1939 Business-Consumer Relations Conference on Advertising and Selling Practices in the Financial, Merchandise, and Service Fields of Business was held in Buffalo under the auspices of the National Association of Better Business Bureaus. It was the first important conference devoted entirely to the discussion of Business-Consumer Relations.

1940 The Wool Products Labeling Act of 1939 became effective.

1942 Council of Organized Consumers, a federation of local, regional, and national consumer groups, was organized at the annual conference of Consumers Union. At the outset, it was planned to confine the Council's activities to informational work, centering on publication of a monthly bulletin on methods of promoting consumer-education projects.

Thus by the early 1940's a considerable number of agencies both inside and outside the government were applying themselves to consumer problems. In addition, certain large independent organizations established for other purposes had undertaken consumer activities, such as conferences, reports, and study programs, as a result of demand from their members. These organizations included the General Federation of Women's Clubs (2,250,000 members),[1] the American Association of University Women (61,500), the National League of Women Voters (48,000), the American Home Economics Association (82,500), the National Congress of Parents and Teachers (2,250,000), and the National Federation of Business and Professional Women's Clubs (70,000). Testing, information, and rating services were active. Besides the consumer-financed organizations, such as Consumers' Research, Inc., Consumers Union, and the Inter-Mountain Consumers' Service, there were a large number of services operated professionally or in the interests of business, such as the Good Housekeeping Institute, the Parents Magazine Advisory Service, the acceptance service of the American Medical Association Council on Foods, and the Fact Bulletin Service of the Better Business Bureaus.

As of 1942, the principal agencies of the Federal government interesting themselves in the consumer included the Consumers' Project of the Department of Labor (a remnant of the Consumers' Advisory Board of the NRA and the Consumers' Division of the NEC), the Consumers' Counsel Division of the AAA (likewise one of the agencies established during the early days of the New Deal), the Bureau of Home Economics of the Department of Agriculture, the Federal Trade Commission, the Food and Drug Administration, and the Consumer Division of the Office of Price Administration.

Under the Wheeler-Lea amendments the Federal Trade Commission became a major governmental agency for consumer protection. These amendments made unlawful unfair or deceptive acts or practices, as well as unfair methods of competition; and specifically declared unlawful the dissemination of false advertisements of foods, drugs, health devices, or cosmetics. Thus the authority of the Federal Trade Commission was greatly extended.

Initially the Federal Trade Commission had dealt with individual cases of unfair competition as they arose. Then for several years beginning in 1919 the trade practice conference procedure was in effect, under which members of entire industries voluntarily cooperated with the Federal Trade Commission in establishing Fair Trade Practice Rules for the wholesale elimination of unfair methods of competition and trade abuses. In 1937 the Commission began writing its own rules. The rayon rules were the first, requiring disclosure of the material content of merchandise containing rayon. In 1938, similar rules were issued with respect to merchandise containing silk; and still later a separate act was passed by Congress, the Wool Labeling Act of 1939, requiring full and accurate labeling of wool products. Beginning in 1938, furs and garments made wholly or in part of fur were required to be fully and accurately labeled; specifically (among other things) it was declared illegal to make false, misleading, or deceptive statements or representations concerning the grade, quality, substance, character, material, name, nature, or zoological origin of any furs or fur products. In 1938 also rules were issued requiring statement of the percentage of residual shrinkage, if any, in conjunction with such terms as "preshrunk" and "shrinkproof" on woven cotton goods. And in the case of mixed goods, each constituent fibre or material was required to be disclosed in the order of its predominance by weight.[1]

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[1] In this enumeration the figures in parentheses denote the approximate affiliated individual membership of the several organizations. The figures are Dr. Gabler's.

The Food and Drug Administration of the U.S. Department of Agriculture was charged with the administration of the Federal Food, Drug, and Cosmetic Law, which prohibited, among other things, the sale of adulterated drugs or cosmetics, the use of false or misleading labeling, and the use of misleading containers, and which required that labels on drugs and cosmetics carry the name and place of business of the manufacturer, packer, or distributor, a statement of the contents in terms of weight, measure, or numerical count, directions for use, precautions with respect to deterioration, and so on.

In the setting up of defense agencies the importance of the consumer's interests was recognized, and a Consumer Division was established in the National Defense Advisory Commission (May, 1940). This Consumer Division subsequently became a part of the Office of Price Administration and Civilian Supply and later of the Office of Price Administration.

An important aspect of the Consumer Movement which should not be overlooked is the development of consumer education. Classes are conducted in public schools and in colleges as well as among adult education groups, covering various topics designed to make consumers better buyers. At least 20 states are said to have fostered courses in the public schools which include projects and study materials in the field of consumer welfare. Affiliated student clubs of the American Home Economics Association are located in 47 states. The Consumers' Counsel Division of the AAA has listed 420 high schools which include the study of consumer problems in their curricula.

Because of the activities and utterances of enthusiasts belonging to the "lunatic fringe" inevitably attaching itself to such a cause, many authorities on marketing have been inclined to disparage the Consumer Movement. In contrast to this attitude may be cited the position taken by Neil H. Borden in *The Economic Effects of Advertising:*[2]

> The incompleteness of information in manufacturers' advertising has accounted not only for the interest of some consumers in informational labeling, but also for other moves by consumer groups to increase the fund of information regarding varying patterns of consumption and regarding the wise selection and proper use of products. Among the methods adopted by them are consumer education in schools and colleges and the formation of organizations to advise consumers regarding product choices.
>
> From the standpoint of maximizing consumer satisfactions, such movements and activities are to be deemed natural and desirable developments. A free society assumes the necessity of self-interest to guide the actions not only of producers but

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[1] For a convenient summary of Federal Trade Commission rulings applying to merchandise sold in department stores, see *The Retailer's Reference Book of Federal Trade Commission Rulings*, published by the Merchandising Division of the National Retail Dry Goods Association (New York, 1939).

[2] (Chicago, Irwin, 1942), pp. 672–673.

also of consumers. This assumption requires that consumers know what their interests are. As the range of products has increased, consumers have lacked the complete information needed to be certain of choosing the most satisfying of the options open to them. Moreover, sellers have been in a relatively dominant position in the matter of using influence in the exchange process. Each seller has been able to know his merchandise well, whereas the untutored buyer has had to learn the merits of thousands of items. Any moves made to strengthen the position of the buyer are deemed desirable, whether these be designed to make him wary in his buying, to help him get information which might supplement that gained in selling presentation, to train him how to use products in order to gain the greatest satisfactions from them, or to let him see clearly the probable satisfactions coming from alternative patterns of consumption. In spite of the many shortcomings of these consumer efforts they have come into existence to meet a need, namely, to help consumers improve their choices among merchandise offered.

It is believed that sellers should recognize both the right and the desirability of individual consumers and consumer groups to be aggressive in furthering methods to educate other consumers and to provide additional desired product information. In keeping with the postulates of a free economy, this study of advertising has advocated freedom of choice and freedom in the use of influence. But the use of influence permeates a democratic society. If sellers use influence in their advertising and personal selling, then they must recognize that consumers on their part should be equally free to use influence.

It is too early to appraise the effects of the Second World War on the Consumer Movement. It may be remarked, however, that one result which became visible in 1942 was the shift of much advertising to copy of an informative character, stressing means of prolonging the life of existing merchandise rather than seeking to promote further sales of new goods.

Broadly associated with, but in purpose distinct from, the Consumer Movement is the consumer cooperative movement. Dr. Gabler differentiates the consumer cooperative movement from the Consumer Movement as follows:

Consumer cooperatives are a distinct section of the entire consumer movement. Consumer cooperation has a much wider scope than the consumer movement. Consumer cooperatives on the one hand fully back the major aims and purposes of the consumer movement. On the other hand, however, the consumer movement does not necessarily lead toward consumer cooperation. Many groups in the consumer movement are definitely opposed to consumer cooperation. A dissatisfied consumer movement, however, may easily lead toward increased interest in consumer cooperation.

. . . What is a consumer cooperative? A consumer cooperative is a voluntary association of consumers whose purpose is to share (on the basis of use rather then profit) any savings that may be had by organizing under their own management the functions of production or distribution, or both. In this way they hope to get lower prices or higher quality for the goods and services they need by eliminating the usual retailer's, wholesaler's profits, and in some cases, manufacturer's profits and also by eliminating unwanted and unnecessary marketing functions at all three distributive levels.[1]

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[1] Gabler, *op. cit.*, p. 49.

APPENDIX *A*

COMPARISON OF WHOLESALE PRICES OF IDENTICAL SUBSTANCES SOLD UNDER PROPRIETARY AND NONPROPRIETARY NAMES

(Net prices to retailers July, 1938)

Brand Name	Price per Ounce *	Chemical Name	Price per Ounce *	Saving under Chemical Name	
				Amount	Percent
Phenacetin	$ 0.63	Acetophenetidine	$ 0.21	$ 0.42	66.7%
Bayer Aspirin	0.75	Acetylsalicylic acid	0.13	0.62	82.7
Veronal	3.00	Barbital	0.56	2.44	81.3
Veronal sodium	3.00	Barbital sodium	0.62	2.38	79.3
Atophan	2.75	Anchophen	0.38	2.37	86.2
Duotal-Withrop	1.07	Guaiacol carbonate	0.29	0.78	72.9
Urotropin	0.25	Methenamine	0.13	0.12	48.0
Luminal	6.90	Phenobarbital	0.57	6.33	91.7
Luminal sodium	6.90	Phenobarbital sodium	0.57	6.33	91.7
Trinol-Withrop	1.90	Sulphonethylmethane	0.70	1.20	63.2
Aristol-Withrop	1.80	Thymol-iodide	0.43	1.37	76.1
Total	$28.95	....	$4.59	$24.36	76.3%†

* Price data obtained from Blue Price List Section, published by *American Druggist*, July, 1938.

† Average, unweighted.

Source: Temporary National Economic Committee, Monograph No. 1, *Price Behavior and Business Policy*, Senate Committee Print, 76th Cong., 3rd Sess. (Washington, D.C., U.S. Government Printing Office, 1940), Table 6, p. 81.

APPENDIX *B*

COMPARISON OF RETAIL PRICES OF DRUGS, COSMETICS, AND FOODS, WITH THE COSTS OF THEIR INGREDIENTS

Product Name	Advertised Use	Quantity	Cost of Ingredients		Retail Price under Brand Name
			Wholesale	Retail	
Proprietary medicines: Carpentier's Compound [a]	Cure for TB and ulcers of stomach	Per jar	$0.50	......	$ 7.00
Currier's Tablets [b]	Ulcers of stomach, hyperacidity, general gastric distress	100 tablets	....	$1.85 [c]	5.00
Renesol [d]	Phenobarbital and baking-soda tablets	65 capsules	....	3.98	4.50
Electrovita [e]	Stomach	1 gal.	....	0.02	2.00
Mouthwashes: Listerine [f]	....	....	Few cents	.....	About 1.00
Dental remedy: OraNoid [g]	Dental remedy	Per can	0.10	......	2.00
Reducing agent: Germania Herb Tea [h]	....	Per package	0.15	......	1.50
Lesser [i]	Bathing salts	Per package	Few cents	......	1.00
Min-amin [j]	Vitamin food	5 oz.	Few cents	......	1.00
Pomay Rx [k]	Salve	8 oz.	About 40 cents	......	10.00
Stardom's Holly-Diet [l]	Reducing food	Package	2–3 cents	......	1–2
Cure for baldness: Downing's Cure [m]	....	4 bottles of different substances	0.65	......	5.00
Cosmetics: Coty's Dusting Powder [n]	....	4.708 oz.	....	0.157	0.75
Coty's Face Powder [o]	....	1.818 oz.	....	0.120	0.75
Elizabeth Arden Face Powder [o]	....	5.345 oz.	....	0.338	3.00
Elizabeth Arden Dusting Powder Venetian [p]	....	11.244 oz.	....	0.466	3.00
Harriett Hubbard Ayer Face Powder [q]	....	2.262 oz.	....	0.066	0.60
Harriett Hubbard Ayer Ayeristocrat Bath Powder [q]	....	10.170 oz.	....	0.220	1.65
Daggett and Ramsdell Dusting Powder [q]	....	4.883 oz.	....	0.160	0.85
Daggett and Ramsdell Face Powder [q]	....	2.934 oz.	....	0.094	0.85
Max Factor Face Powder [r]	....	4.584 oz.	....	0.118	0.75
Helena Rubenstein Face Powder [r]	....	2.644 oz.	....	0.100	1.00
Bourjois Sales Corp. Poudre Java [s]	....	3.332 oz.	....	0.098	0.50
Evening in Paris Bath Dusting Powder [t]	....	5.020 oz.	....	0.164	1.10
Evening in Paris Face Powder with Perfume [u]	....	....	....	0.174	1.10
Richard Hudnut Face Powder Marvelous [v]	....	2.479 oz.	....	0.065	0.55
Luzier's Face Powder [w]	....	1.872 oz.	....	0.077	1.00
Luzier's Cleansing Cream [x]	....	5.700 oz.	....	0.197	2.50
Luzier's Lu Mar Massage Cream [x]	....	1.802 oz.	....	0.140	3.00
Luzier's Lutone Skin Cream [x]	....	2.109 oz.	....	0.061	1.00
Coty Rouge Refill [n]	....	0.148 oz.	....	0.037	0.38
Max Factor Dry Rouge [r]	....	0.300 oz.	....	0.082	0.38
Luzier Rouge [v]	....	0.317 oz.	....	0.143	1.00
Harriett Hubbard Ayer Cream Rouge [p]	....	0.315 oz.	....	0.038	0.55
Elizabeth Arden Venetian Lip Paste [o]	....	0.357 oz.	....	0.024	1.00

APPENDIX *B* (*Continued*)

Product Name	Advertised Use	Quantity	Cost of Ingredients		Retail Price under Brand Name
			Wholesale	Retail	
Cosmetics: Springtime in Paris Lipstick [s]	....	0.140 oz.	....	$0.737	$1.25
Bourjois Sales Corp. Lipstick [s]	....	0.070 oz.	....	0.031	0.55
Coty's Special Astringent [o]	....	4.000 oz.	...	0.071	1.00
Harriett Hubbard Ayer Special Astringent [p]	....	11.993 oz.	...	0.088	1.75
Primrose House Skin Freshener [r]	....	4.000 oz.	...	0.061	0.85
Luzier Skin Refreshener [x]	....	1.910 oz.	..	0.087	2.50
Elizabeth Arden Venetian Dermatex Depilatory [p]	....	2.323 oz.	....	0.190	2.00
Evening in Paris Perfume [s]	....	0.550 oz.	....	0.268	2.75
Springtime in Paris Double Vanity [t]	....	0.058 oz.	...	0.252	1.75
Barbara Gould Cuticle Remover [t]	....	0.566 oz.	....	0.053	0.55
Barbara Gould Hand Lotion [u]	....	3.999 oz.	....	0.082	0.45
Food: Ovaltine [y]	....	14 oz.	....	0.100	0.75
Instant Alberty's Food [z]	....	16 oz.	....	0.200	1.35
Chemm [z]	....	16 oz.	....	0.140	0.59

[a] *Journal of the American Medical Association*, Vol. 101, No. 12 (Sept. 2, 1933), p. 795.

[b] *Ibid.*, Vol. 101, No. 3 (July 15, 1933), p. 227.

[c] Retail price under nonproprietary name.

[d] *Journal of the American Medical Association*, Vol. 98, No. 8 (Feb. 20, 1932), pp. 658-660.

[e] *Ibid.*, Vol. 98, No. 4 (Jan. 23, 1932), pp. 337, 338.

[f] *Ibid.*, Vol. 85, No. 1 (July 4, 1925), p. 55.

[g] *Ibid.*, Vol. 92, No. 10 (Mar. 9, 1929), p. 828.

[h] *Ibid.*, Apr. 8, 1933, p. 1126.

[i] *Ibid.*, Vol. 92, No. 6 (Feb. 9, 1929), pp. 492–495.

[j] *Ibid.*, Vol. 104, No. 4 (Jan. 26, 1935), pp. 335, 336.

[k] *Ibid.*, Vol. 109, No. 14 (Oct. 2, 1937), p. 1142.

[l] *Ibid.*, Vol. 102, No. 4 (June 16, 1934), pp. 2041, 2042.

[m] *Ibid.*, Vol. 110, No. 7 (Apr. 23, 1938), p. 1385.

[n] Legislative Document of the State of Maine, No. 683, 1935, prepared by Dr. G. R Coomb, director, Bureau of Health, p. 26.

[o] *Ibid.*, p. 27.

[p] *Ibid.*, p. 28.

[q] *Ibid.*, p. 29.

[r] *Ibid.*, p. 30.

[s] *Ibid.*, p. 31.

[t] *Ibid.*, p. 32.

[u] *Ibid.*, p. 33.

[v] *Ibid.*, p. 34.

[w] *Ibid.*, p. 36.

[x] *Ibid.*, p. 35.

[y] Hearings before subcommittee on Interstate and Foreign Commerce, House of Representatives, H. R. 6906, H. R. 8805, H. R. 8941, and S. 5, July and August 1935, p. 371.

[z] *Ibid.*, p. 381.

Source: Temporary National Economic Committee, Monograph No. 1, *Price Behavior and Business Policy*, Senate Committee Print, 76th Cong., 3rd Sess. (Washington, D.C., U.S. Government Printing Office, 1940), Table 7, pp. 82–83.

VII. PLANNING AND ADMINISTRATION OF SALES PROGRAMS

THE ECONOMIC EFFECTS OF ADVERTISING

BY NEIL H. BORDEN

THE SIGNIFICANCE OF THE STUDY

During the dozen years since the end of the business boom period of the 1920's there has been increasing public consciousness of advertising as a problem. The growth of this consciousness stems from a variety of sources: Disillusion fostered by depression caused many people to turn critical eyes on numerous practices of business. Popular interest in consumption economics gained force, and the Consumer Movement attracted a substantial following. Modern economists in their theories of imperfect, or monopolistic, competition began to pay special attention to the effects of aggressive selling costs on prices. A vigorous revival of antitrust sentiment on the part of the government took as one of its targets certain advertising practices of large business concerns. At the same time, through an increasing utilization of a new medium, the radio, advertising was becoming even more omnipresent and inescapable in its clamor for attention. Simultaneously, also, the emphasis of advertising on appeals to emotion and instinct rather than to reason apparently increased. The composite net result of all these and numerous other factors has been to place a perceptible question mark on the social usefulness of present-day advertising expenditures and practices.

As the critics of advertising have waxed in numbers and strength, the defenders have not been lacking. Strong statements have come from both camps: on the one hand, "advertising is a waste and a social liability"; on the other, "advertising is a principal factor in placing goods in consumers' hands at ever lower costs." Unfortunately, neither side has been strongly fortified with facts; and so, as the public has gradually grown aware that there are important social problems with respect to advertising, because of this paucity of facts it has had little ability to judge the real merits of the controversy.

The Harvard Business School consequently welcomed the opportunity to

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Source: Chicago, Irwin, 1942, pp. xv–xl. A statement by the advisory committee appointed from the faculty of the Harvard Business School to give Professor Borden counsel and assistance in directing the study. Excerpts reprinted by permission.

make an initial comprehensive factual study of consumer advertising,[1] with special reference to the economic problems. Because of the importance of these questions, a committee, representing several points of view among the Faculty, was appointed to exercise broad supervision over the investigation, the general conduct of which was entrusted to Professor Borden. That the confidence which the committee had in Professor Borden was fully justified is, in its opinion, fully substantiated by the results.

Although it was essential that the study be comprehensive in scope, it was also important that the particular problems to be studied should be carefully defined. In the economic area this definition of problems focused the analysis on the place of advertising in a dynamic system of free enterprise: i.e., the assumptions of an individualistic competitive economy were taken as a setting for the study rather than any assumptions appropriate to a socialistic or totalitarian economy. In establishing this ideological framework for the investigation the author had the full approval of the committee.

The committee nevertheless desires to point out that, because the chief concern of this analysis was to examine the economic problems of advertising within the framework of the capitalistic system of free enterprise, it by no means follows that the findings are wholly devoid of significance for those who advocate some other form of social organization. Advertising serves certain functional purposes in any economy, whether the regime be one of private capitalism or of state socialism. In any type of social organization which is not to be wholly static, the function of providing information for consumers in regard to the sorts, qualities, quantities, uses, and special attributes of the products available, and the places where they can be obtained, is a needful one. In fact it may be an even more needful one because of the desire of the state to direct consumption along certain lines. Even if advertising were to be called propaganda and the costs borne by the state, still it would behoove the managers of advertising, and indeed the managers of the state, to understand the problems and the kind of evidence that are presented in this survey. Therefore, those who believe (as the committee and the author do not) that the day of private enterprise in the United States is fast drawing to a close should not on that account dismiss this study as merely part of the swan song of capitalistic ideology.

The Nature of the Problems

Three Kinds of Problems Studies

The existence in the social structure of advertising or, more generally, of aggressive promotional practices, gives rise to at least three broad interrelated categories of problems: business problems, economic problems, and ethical problems. The concern of the businessman is with the profitable use of advertising as a tool of sales promotion. The concern of the economist is with the effects of advertising on the national income and on the social welfare generally. The concern of the moralist is with the relation of advertising to the prevailing social code as expressed in law or in accepted conventions of behavior and good taste.

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[1] Although at various points throughout Professor Borden's analysis, reference in one form or another is made to industrial advertising, the predominant emphasis throughout the book is laid on consumer advertising since it is in this area that most of the controversy over the economic issues created by advertising has been waged. Limitations of both time and funds rather than any lack of appreciation of its importance made a correspondingly careful analysis of industrial advertising impossible. It is earnestly to be hoped that such a study, comparable in scope to the present one in the consumer area, may be made possible.

THE BUSINESS PROBLEM

The businessman asks, "Where is the opportunity for the successful use of advertising to enhance profits? Where will advertising do a more effective job than some other tool of sales promotion? How can advertising be improved? How can its costs be lowered in relation to its results? How can its results be more accurately determined and predicted?" . . . In the opinion of the committee it is necessary to possess a sound understanding of the business problems of advertising in order to have a good background for evaluating the economic and ethical problems.

THE ECONOMIC PROBLEM

The economist inquires, "Does advertising enhance the social welfare? Does it operate to increase or decrease the national income? Does advertising make prices rigid and unresponsive to changes in economic conditions? Does it increase or restrict the freedom of consumer choice?" The nature of these problems as they grow out of economic theory [and] . . . the development of these issues, since this is primarily a study of the economics of advertising, constitutes the bulk of the book.

For the benefit of the lay reader, whose general acquaintance with economic doctrines is probably confined mostly to the main outlines of thought of nineteenth and twentieth century English and American economists, the fact that more recent economic thought covers a wider range needs to be emphasized. Instead of remaining within the traditional channels of the private-enterprise system, it envisages other forms of economic organization, both tried and untried. The discussion of advertising by modern economists reflects this current width of range, and some of the criticisms of advertising proceed from assumptions different from those of the nineteenth century economists. It is therefore appropriate at this point to indicate precisely how the economic issues were defined in undertaking this investigation of advertising.

Advertising is sometimes criticized on the ground that as part of the capitalistic system of free enterprise it leads consumers to buy the wrong things and spend too much for them, whereas consumers would be better off if they bought different things and spent their money in different ways. When this criticism implies, as it often does, that someone in authority might better decide what things should be bought and how consumers should spend their incomes, then the essential clash is between the rival ideologies of individualism and authoritarianism; and the basic argument is not really about advertising at all. Therefore, whenever criticisms of advertising carry the implication that some other form of social organization would be preferable to one based on freedom of consumer choice and freedom of enterprise, the debate passes beyond the scope of this study.

In the same way there are excluded from the scope of this study those criticisms of advertising which take issue with its emphasis on enhancement of material values at the expense of spiritual values. As to whether or not the satisfaction of material wants interferes with the good life, and as to whether the sum total of human happiness would be greater or smaller in a world of more asceticism and less gratification of desire, this study must be silent. These broad issues both of moral and economic ideology must be contested on other battlegrounds.

Therefore the basic economic issue which was propounded for this investigation may be phrased as follows: Within the framework of a dynamic capitalistic system of free enterprise, does advertising (and sales promotional practices generally) help or hinder the successful functioning of the economy and the advance toward a greater measure of well being? By "a dynamic capitalistic system of free enterprise" is meant a system in which consumers are free to decide how they will spend their incomes, in which businessmen are free to decide the direction and scope of their activities and free to set prices for their goods and services, in which labor is free to bargain collectively or individually as it desires, in which investors are free to place their funds in whatever enterprises they see fit, in which the liberties of individuals, including the liberty to own and enjoy property, are safeguarded by the state, and in which change and innovation are accepted as the normal expectation, the whole being subject to such restraints as are imposed voluntarily by the community for the better protection of these several freedoms. Such a system is substantially that under which the whole economic and cultural development of the United States has taken place.

At this juncture the general reader, unless he is familiar with some important lines of development in economic thought during the past twenty years, may well ask, "How does the hypothesis arise that advertising may hinder the successful functioning of a capitalistic economy?" To answer this question it is necessary to outline briefly some of the recent thinking of economists with regard to the character of present-day competition.

Modern economists are more realistic than some of their predecessors. They recognize that the concepts of pure competition and pure monopoly are simply concepts and not very good descriptions of the actual world. The concept of pure competition assumes a market in which there are a large number of buyers and sellers, in which the commodity traded is essentially homogeneous and nondifferentiated, in which competition is entirely on the basis of price, and in which price is determined impersonally in the market place, since no seller or buyer is large enough to affect the calculations of any other seller or buyer. In such a market advertising to convince buyers that they ought to prefer the product of a particular seller would be neither necessary nor competitively possible, since the product is homogeneous and competition is solely on a price basis. It goes without saying, of course, that almost nowhere in the modern business world does such a market actually exist. Only in the case of certain agricultural commodities is this concept of pure competition at all closely approached.

At the opposite extreme lies the concept of pure monopoly, which envisages a single seller in control of the complete supply of a commodity and thus able, by virtue of this control of supply, to set and maintain the price at the level which he deems most likely to maximize his total profits. Again it is true that in the world of today there are very few instances of such pure monopolies (except in the case of some government monopolies). Perhaps the closest approach in the business world is the De Beers diamond syndicate, and even that has close governmental affiliations.

In establishing these concepts of competition and monopoly the eighteenth and nineteenth century economists by no means imagined that they were describing the actual world of business. On the contrary, they recognized that there were numerous imperfections in competition in the real world. However, they dismissed the imperfections as being relatively unimportant and concentrated their attention on the *tendencies* toward competition and toward monopoly. This general point of view persisted for a long time. Although some nineteenth century economists examined the curious riddle of duopoly (a situation in which two competing firms control the whole supply), it remained for economists of the twentieth century, especially in the twenty-odd years between the first and second World Wars, to recognize that in the real world actual competition is so different from the concept of pure competition that instead of dismissing the imperfections and dwelling on the abstract concepts, thoughtful students needed to focus attention on the imperfections themselves and build their theories around them.

Take cigarettes as an example of present-day competition. The individual sellers differentiate their products hoping to gain consumer preference. Although Camels and Lucky Strikes are in competition they are not, strictly speaking, homogeneous products. They represent different blends of tobacco, different processes of curing and preparation; and each company has a monopoly of sorts; that is to say, it has a monopoly of its own brand. Cigarette competition is largely on a nonprice basis, taking the form of advertising, sales promotional efforts and devices of all kinds, as well as differentiation of both product and package. Furthermore, four companies account for approximately 70% of the sales of cigarettes in the United States; and clearly none of these companies can make any competitive move without considering the probable reactions of the other large companies to that move. To be sure, price competition breaks out occasionally in flurries of price cutting; but between these price wars are long periods during which prices remain relatively constant, and in these prices are included the costs of advertising and sales promotional efforts.

Present-day economists, devoting their attention to such imperfections of the market as just illustrated, rather than to abstract concepts, have evolved the theory of monopolistic or imperfect competition, that is, a type of competition embracing aspects both of competition and of monopoly. In this volume the author has used the term "imperfect competition" as being generally synonymous with "monopolistic competition."[1] It is extremely important for the general reader to recognize that except for the names there is nothing new about this kind of competition. The terms "monopolistic competition" or "imperfect competition" merely describe competition as it has existed in the world and particularly in the United States for these many years. Here it may be remarked parenthetically that the term "monopolistic competition" has acquired implications that are emotionally disturbing to some businessmen because it seems to suggest something immoral or illegal. The important question is not whether these kinds of competition exist; everyone concedes that. Monopolistic or imperfect competition is merely a label applied to the everyday realities of American business. The really important question is whether out of this species of competition there flow any consequences seriously different from the general results of the competitive system as postulated by the earlier economists. The real problems are how this competition works and what are its social consequences. Since much of the current criticism of advertising is closely related to the various theories of imperfect competition, businessmen therefore are urged to understand the concept of imperfect competition and the issues which it raises. . . .

Criticisms of advertising grow out of theories based on the important characteristics of monopolistic or imperfect competition. These characteristics include some or all of the following:

1. Individual sellers differentiate both the products themselves and the brands and packages in order to develop a basis for consumer preference.
2. Competition takes a variety of forms of sales promotional effort, including advertising, display, and personal selling, rather than taking predominantly the form of price reductions.
3. Consumers are urged to buy merchandise because of claimed improvements in quality and special features rather than because of reductions in price.
4. There is a tendency toward a concentration of supply in certain industries in the hands of a relatively small number of large concerns.
5. Under such conditions the individual concern has substantial control of its own price. It does not have to accept an impersonal price established in the market place on a take-it-or-leave-it basis; on the contrary, it may elect to exercise its "monopolistic" control over the preferences of some part of its customers and sell a reduced output at a higher price.

From these characteristics of imperfect competition certain serious consequences to the economic system are apprehended by many present-day economists. Among the consequences suggested by these economists the following may be noted:

1. Consumers are confused by the large number of meaningless product differentiations and consequently do not make wise choices.
2. Consumers do not have sufficient opportunity to buy goods at low prices. In this sense their freedom of choice is restricted.
3. Since business firms seek to recover costs of advertising and sales pro-

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[1] Among economists both terms have their supporters, but minor shades of meaning are not significant for purposes of this study.

motion, and since under conditions of imperfect competition they refrain to a large extent from using the weapon of price, consumers are forced to pay too much for the goods they buy.

4. Many aggressive marketing costs thus are wastes which retard the growth of the national income of real goods.

5. Because of these consequences, imperfect competition is not automatically self-regulating in the social interest; that is, it does not direct investment into certain channels and away from other channels in such a way as to meet the community's real demands.

6. The result of this improper allocation of capital investment is underutilization of productive capacity and underemployment.

7. Since imperfect competition is accompanied by relatively rigid prices it prevents the price mechanism from absorbing the shocks of change in the economic system, and these shocks thus fall on output and employment. Thus imperfect competition increases the severity of cyclical fluctuations in business.

It is obvious that the argument about imperfect competition is considerably broader than the argument about advertising, but it is also obvious that the criticisms of advertising are so closely intertwined with the theory of imperfect competition that businessmen cannot understand one without some grasp of the other.

With reference to the economic problems of advertising, therefore, it was the task of this investigation, taking cognizance of the theories of imperfect competition and the position of advertising in those theories, to collect and examine facts bearing on the effects of advertising in the United States on demand, on cost, on price, on the quality and variety of goods, and on the general level of national income. In examining these facts, it was deemed appropriate to take not merely a static view but also a dynamic view. In other words, it was not considered sufficient to look merely at the effects of advertising at a particular level of economic development but it was thought necessary to look also at advertising in relation to the process of economic change—to consider its effects on the flow of investment and on the mechanisms by which the qualities of goods are improved and the standard of living raised, i.e., the way in which the community moves from one level of income to a higher one. With this longer time span of judgment it is also more readily possible to observe the action of any counteracting forces which may operate to modify the results suggested by a more static type of analysis.

Just as it is important that businessmen should understand the current economic theories of imperfect competition, it is likewise important that economists, in the further development of these theories, should take into account the kinds of information which this study has sought to assemble, in order to see whether the existing doctrines of imperfect competition are adequate as a theory of economic progress.

THE ETHICAL PROBLEM

Somewhat apart from the economic problem, which has been discussed at some length and which constitutes the chief objective of this study, there are certain ethical problems with respect to advertising. To what standards of conduct, either as written into statutes or expressed in the conventions and codes of the business community, should advertising be expected to conform? How far does it so conform?

But first, why should these problems be treated separately? It would be foolish to suppose that with respect to advertising there are no connections between the economic problems and the ethical problems. Advertising is forced to change in order to meet changing ethical concepts, and these changes in advertising naturally have a bearing on its economic results. Nevertheless a separate treatment of the two kinds of problems is amply justified. The kinds of advertising claims which may not be inappropriate to the taste of one generation may offend the ethical sensibilities of a succeeding generation; such changing influences are readily traceable in the history of advertising in the United States. Thus the ethical standards for advertising, in common with other ethical standards, are on a pragmatic basis. They change as the views of the community change. On the other hand, the science of economics concerns itself with cause and effect in the economic realm rather than with the desirability or undesirability of particular ends and objectives; and the logic of this cause and effect, so far as it is correctly apprehended, does not change, is not in any sense pragmatic. Thus economic problems and ethical problems, although not devoid of interconnection, need to be approached with different assumptions.

Some critics take the chief ethical problem of advertising to be the question whether any influence of persuasion is properly admissible in dealings between buyers and sellers, their answers to this problem being predominantly in the negative. But again, as in the case of some of the economic criticisms of advertising, this denial of the propriety of persuasion in economic affairs resolves itself at bottom into a profound ideological cleavage. What significance can be attached to the designation of a society as "free" if there is no freedom to exercise persuasion in the relationship between buyers and sellers? Persuasion and counterpersuasion are exercised freely from pulpit, press, rostrum, classroom, and government agencies for information. If the use of persuasion were to be forbidden in economic relations, practically all semblance of free society would vanish at the same time.

The really significant ethical problem in regard to advertising, therefore, is not *whether* persuasion should be exercised but *how* it should be exercised. In other words, what are the ethics of influence in economic relationships? Not only do such ethical standards change from time to time as suggested above, but they are also pragmatic in another sense. Codes of ethics and ethical standards are by no means uniform for all professions or all occupations at the same time. They differ according to what is appropriate to the circumstances. The ethical standards which govern a judge on the bench are vastly different from those which are appropriate to the prosecutor and the attorney for the defense. For a judge to fail to be impartial would be highly unethical, but for an advocate before the bar to present only one side of the case is in no sense unethical.

The ethical problems which are appropriate for the study of advertising, therefore, are the ethics of the use of influence in competitive commercial relations. What changes are taking place in these standards of advertising conduct? How rapidly are they being written into statutory law? Is the law moving sufficiently fast to keep pace with the ethical sense of the business community? What are the effects of those standards of advertising conduct which are not yet embodied in law but have crystallized in certain conventions, in business codes, and in the activities of particular extralegal organizations, such as the Better Business Bureaus? What do consumers think about advertising? Are businessmen themselves sufficiently aware of changing standards of good taste with respect to advertising? . . .

The Major Findings of the Study

The material included in this study represents by far the largest body of evidence that has yet been gathered on advertising. The commodities selected for analysis so far as possible represent a sample of market conditions; yet the quality of the evidence is uneven. Some parts are much better than others, and in some important areas evidence is scanty or lacking. It is understandable that this first effort to make a comprehensive survey of the facts should reveal many areas in which satisfactory data are not as yet obtainable. For instance, evidence as to the effects of advertising on costs is disappointing in both quantity and quality. This particular defect in the evidence is part and parcel of the general truth that the businessman's knowledge of costs, and, indeed, the behavior of costs in business, by no means presents the clear-cut picture that the economist is prone to visualize. Some of the evidence that the economist looks for probably does not exist. In a broad sense most of the defects in the evidence presented in this volume must be regarded as unavoidable in any initial study having consideration for reasonableness of research outlays.

It would be a mistake to suppose that the evidence presented in this volume yields simple "yes" and "no" answers to all the major questions about advertising. Nevertheless the material on which this study is based, comprising hundreds of case histories, hundreds of interviews with business executives, thousands of pages of records examined, a substantial number of industry studies, and other special investigations—all this (in the opinion of the committee) constitutes a factual array that cannot be ignored when advertising is discussed honestly and thoughtfully. In the future, as the facts uncovered in this survey are augmented, corrected, and refined, there can no longer be any real excuse for either the critics or the supporters of advertising to jump at quick conclusions. There is ample evidence here to show that the facts of each advertising situation have to be carefully examined before they are used as a basis for any generalizations.

. . . In order to give the general reader a preview of the findings of this investigation, some of the principal generalizations which are supported by a preponderance of the evidence are listed here. . . .

GENERALIZATIONS ON THE QUANTITATIVE ASPECTS OF ADVERTISING

I. Since 1920, advertising expenditures in the United States have probably averaged in excess of $2,000,000,000 a year, or roughly 3% of the national income.

II. For 1935, advertising expenditures amounted to 1.4% of the total sales volume of businesses using an appreciable quantity of advertising, but to only 0.9% of the total dollar sales transactions of all types of business.

III. These expenditures for advertising comprised 7% of the total outlay for the distribution of goods and services.

IV. The public gets an important indirect benefit from advertising through the contribution of advertising revenue to the gross expenses of newspapers, magazines, and radio broadcasting. Roughly one-fifth of total advertising outlays, or $400,000,000 in the year 1935, was returned to consumers in the form of lower costs for publication and radio entertainment.

V. In the aggregate, wages of salesmen, traveling, and other costs attending personal selling efforts on the part of manufacturers, wholesalers, and retailers are several times as large as the outlays chargeable to advertising.

GENERALIZATIONS ON THE BUSINESS USE OF ADVERTISING

I. The businessman generally seeks to use advertising with the objective of obtaining long-run profits rather than immediate returns. The purpose of advertising is to induce continued patronage.

II. Opportunities for the successful use of advertising vary widely. Advertising is not a business stimulator which can be turned on and off at will with the assurance that results will be commensurate with expenditures. Successful advertising depends on the right combination of numerous factors. Among factors favorable to the successful use of advertising are the following:

A. The trend of demand in the particular industry should be rising.

B. There should be an opportunity to stimulate selective demand, i.e., brand preference for the particular product. This opportunity is most likely to be present under such circumstances as the following:

1. When there is substantial chance for differentiation of product.
2. When consumer satisfaction depends largely on hidden qualities that cannot easily be judged at the time of purchase, for instance, toilet soap as contrasted with green vegetables.
3. When strong emotional buying motives exist, such as protection of health or enhancement of social position.

C. The combination of potential unit sales times rate of gross margin must be high enough to permit necessary advertising expenditures in the particular market.

Where a preponderance of these conditions is present there is much greater opportunity for effective advertising than where the reverse is true. For instance, cosmetics exemplify the type of product for which most of the foregoing conditions are present, whereas sugar is a type of product for which many of these conditions are not present.

III. Advertising is not homogeneous, isolated, or unique. Instead, it is an integral part of a business plan. Where the opportunity for successful advertising exists, the business use of advertising will still not be fully successful unless the following conditions are met:

A. There must be a correct appraisal of the most suitable combination of advertising and price policy. Advertising affects the unit sales volume and thus indirectly the production cost per unit. Price likewise affects the unit sales volume and also affects the total dollar income and the total amount of gross margin. Advertising, in addition to affecting unit sales, of course increases marketing expense outlays. Gross margin less marketing and administrative expense equals net profits. Thus, with a view to maximizing profits there must be a correct appraisal of the best balance of the combination of advertising and price.

B. Advertising must be effectively coordinated with the other parts of the marketing and merchandising program, including the personal selling effort and all aspects of relations with middlemen.

C. The advertising task itself must be skillfully executed, especially with reference to the following factors:

1. There must be a correct determination of the audience to be addressed.
2. Selling appeals must be selected which are most likely to influence those to whom advertisements are addressed.
3. Techniques and methods must be developed for effectively presenting the appeals.
4. The most effective media available for reaching the audience must be judged on a basis of cost in relation to influence on the audience.
5. It is necessary to determine the best size and frequency of advertisements to produce the maximum effect with a given expenditure.

IV. Where the foregoing tasks of judgment and execution are not effectively accomplished, advertising results in waste. Businessmen are aware of this waste as it affects their own profits, and they seek to reduce it through the improvement of techniques.

A. The dynamic character of business makes control and measurement of advertising results highly important, yet difficult, because of changing living habits and attitudes, changing fashions, changing population, changing price structure, changing competitive situation, and the increased tempo of change.

B. Useful techniques for reducing advertising waste include the following:

1. Market studies are increasing in number and are utilizing greater technical refinements.
2. Improved methods are being developed for controlling marketing operations, such as the use of sales quotas and distribution cost analysis.
3. The search continues for methods of measuring advertising results, such as keyed responses, controlled experiments, use of coupons, tests of readership and listening habits, test campaigns, and pretesting of advertisements by consumer juries.

C. There are various obstacles to the full development of techniques for preventing advertising waste.

1. Some businessmen have unlimited faith in the ability of advertising to operate automatically to increase profits, and others are unduly skeptical.

2. The practice sometimes followed of having advertising agencies compete for accounts on a speculative basis leads to inadequate preliminary study.

3. Some advertisers show unwillingness to furnish agents with adequate information on their businesses.

4. Some businessmen and advertising agents rely too much on hunch and unchecked promotional artistry.

D. The development of techniques for preventing waste in the field of advertising has not equaled the corresponding development of techniques for preventing waste in production and in certain aspects of marketing. Nevertheless, advertising presents a more difficult problem than these other areas, and encouraging progress has been made.

GENERALIZATIONS ON THE ECONOMIC RESULTS OF ADVERTISING

I. The Effects of Advertising on Demand

A. For many products advertising tends to speed up favorable trends of demand; that is, if underlying conditions are favorable to an increase in demand for the product, e.g., cigarettes during recent years, the use of advertising tends to enhance and accelerate the rising trend of demand.

B. In the case of a declining trend in demand, e.g., cigars, advertising is powerless to halt or reverse the trend. It can do no more than temporarily delay it.

C. Where possibilities of expanding a market do not exist, or where there is a declining trend of demand, cooperative industry advertising campaigns have not been able to succeed.

D. By aiding in the expansion of markets through accelerating a rising trend of demand, advertising also helps to increase the elasticity of demand.

1. As greater numbers of people become acquainted with a product there is more opportunity to increase dollar sales volume through price reductions.

2. This expansion of markets often is needed in order to make it profitable for a businessman to reduce prices.

3. The expansion may make possible lower costs for individual firms, which can be reflected in price reductions.

E. The expansion of the market also makes it possible for new competitors to enter.

F. The building of the market by means of advertising and other promotional devices not only makes price reductions attractive or possible for large firms, it also creates an opportunity to develop private brands, which generally are offered at lower prices. Many national advertisers consider such competition as parasitic, since there is frequently present an element of trading on the reputation of established brands. The private branding concerns would have much less opportunity to operate if advertising by others did not precede their activities. In spite of the disfavor in which they may be held by national advertisers, private branders who elect to compete on a price basis serve a definitely useful economic function.

G. As a general rule, businessmen, particularly manufacturers, have not fully recognized the opportunities for increasing sales volume and profits through the exploitation of demand elasticity. In general they have been too ready to assume that demand is inelastic, and have not been sufficiently willing to experiment with price strategy.

H. Possibilities for the use of advertising by individual companies vary widely. If the right combination of conditions is present, the effect of advertising is to increase the demand for the particular company's product. There are situations, however, in which it does not pay a company to advertise, because of insufficient product differentiation, lack of strong consumer buying motives, insufficient size and frequency of sale, and so on, e.g., matches, wheat, and nails. Advertising in these cases is highly unlikely to increase the demand for a particular concern's product.

I. Where advertising does operate to increase the demand for the individual concern it tends to make the consumer demand for that product inelastic. That is, it enables the company to maintain its prices when there is a general market decline, and it enables the company to ignore, within limits, price changes on directly or indirectly competing products. This tendency is observed for commodities which are highly differentiated from others and commodities for which consumers have strong emotional buying motives.

J. In the longer run, however, competitive forces tend to weaken the condition of a company which relies on advertising to bring about an inelasticity of its individual demand and thus enable it to ignore price competition, especially during periods of depression. Either other manufacturers or private branders competing on a price basis eventually take business away from the concern which seeks to maintain high prices in the face of lower market levels.

II. The Effects of Advertising on Costs

A. The Effects of Advertising on Total Marketing Costs.

1. Advertising is not in itself the cause of high distribution costs. In a society characterized by increasing complexity of goods and increasing divisions of labor, marketing costs inevitably become a major part of the final price paid by consumers. In such a society the consumers and producers are widely separated in space, time, and knowledge; and division of labor appears not only in manufacturing but also in distribution. As manufacturing costs are reduced by a larger scale of operations, marketing costs usually account for a larger share of the final price. Because consumers and producers are so widely separated and because the products of a modern economy are so varied, informational costs, whether they be incurred for advertising or for personal selling, must make up some substantial part of total marketing costs. Advertising is a part of present-day high distribution costs, but it is not a basic cause of the high proportion of these costs.

2. It is not possible to state precisely whether the presence of advertising in the economic system has the effect of increasing or of reducing marketing costs generally.

a. Although there is a substantial body of information available in regard to marketing costs, there are too many gaps and discontinuities in it. For instance, there is inadequate information on the marketing costs of manufacturers and of certain types of distributors.

b. It is not possible to trace on a large statistical scale the effects of advertising by manufacturers on the expenses and margins of distributors and dealers who handle advertised products. Advertising ordinarily tends to give low selling costs among distributors for the brands advertised. In individual cases it is well established that advertising manufacturers accord smaller margins to middlemen than they normally take on unbranded or privately branded merchandise. Whether these reductions in margins are more or less than sufficient to cover the manufacturers' cost of advertising is uncertain; the evidence is both inadequate and conflicting.

c. In addition there is the further complication which comes from the shifting of promotional functions. A department store or chain store organization with numerous private brands may have a relatively high cost of doing business, but adequate information is not yet available to show how much the performance of these promotional functions by the distributor may have lowered the manufacturers' marketing costs.

d. Although it is frequently argued that advertising may tend to reduce distribution costs because it is an effective substitute for personal selling costs (which commonly run larger than advertising costs), the evidence available does not prove that this contention always holds true. In many instances advertising proves to be a more economical selling method than is personal selling. In other instances advertising is an economical and effective complement to personal selling. But frequently the use of advertising does not bring a reduction in personal selling costs or total marketing costs. Advertising and personal selling are not necessarily interchangeable.

3. There is some evidence pointing to the conclusion that among certain types of middlemen, e.g., department stores, large concerns have higher percentage costs (including advertising) than small companies. Such comparisons, however, are likely to be very misleading.

a. Frequently the variety of merchandise handled by the large firms differs greatly from that handled by the smaller firms.

b. Many large concerns embrace in their activities a considerably greater number of marketing functions than do the small concerns; that is, they reach back directly to the manufacturer instead of being approached by the manufacturer through various intermediaries.

Thus, when some large concerns spend proportionately more for advertising than do their smaller competitors, it is quite possible that they are taking the place of the manufacturer or of some other middleman with respect to such expenditures, and that the sum total cost borne by the consumer may be even less in their case than in that of some of the smaller companies.

4. What interests the consumer, of course, and society at large is the lowest possible combination of production and distribution costs. The fact that while the ratio of marketing costs has been rising final prices to consumers for many articles of merchandise have been lowered, lends credence to the presumption

that in the past higher distribution costs have been more than offset by lower production costs. But it is not possible to make the generalization that higher distribution costs today are always offset by lower production costs. There is evidence that this is true in many cases, but there is no certainty that increased costs of distribution do not, in some instances, result in higher prices to consumers.

B. The Effects of Advertising on Total Manufacturing Costs.

1. In many industries the large scale of operations made possible in part through advertising has resulted in reductions in manufacturing costs.

2. The claim that a large concern which advertises necessarily gains advantages in production costs over nonadvertising or smaller firms is not always based on fact. The evidence shows that small nonadvertising companies sometimes have as low production costs as large companies.

3. Many small firms "ride on the coattails" of their larger competitors. They avoid information costs and let the larger concerns bear the burden of developing the demand. In some of these cases the lower advertising and general marketing costs of these small companies are offset by their higher production costs. This situation suggests that it may be a mistake to view each concern, institution, or function atomistically; that comparisons between small and large concerns or between advertising and nonadvertising concerns are necessarily imperfect; and that costs have organic aspects in society which defy traditional methods of analysis.

4. A special study of production and distribution costs of manufacturers made in connection with this investigation yielded meager and largely unsatisfactory data; but this study did indicate that economists in their reasoning have made unwarranted assumptions about the businessman's knowledge of costs.

a. Businessmen are quite generally unable to furnish the types of cost information required by economic analysis.

b. In general businessmen do not have the precise information about certain categories of cost which the economist's reasoning presupposes.

c. They do not typically use this type of information in their actual operations, because they do not find practical the types of cost information assumed in theory.

A sufficient body of fact does not now exist to warrant many of the statements about cost that have been made both by the proponents and by the opponents of advertising.

III. The Effects of Advertising on Price

A. The long-run effect of advertising and aggressive selling costs on price is closely related to the concept of innovation and growth costs. Since the burden of developing demand is a substantial and costly one, pioneers in any business fairly often must make large outlays before they begin to get any return on their investment. After they have developed a demand, the path is easier for the imitators who follow them, since the latter do not have to incur the same developmental expenses but at the same time are able to take some of the market.

Fearing this situation, the pioneer, of course, seeks to get back his growth costs and assure himself of a long-run profit by utilizing various devices such as patents and trade-marks to obtain something like a temporary monopoly for his product. Brands, product differentiation, and advertising are some of the means which he uses to try to protect his position. The extent to which the pioneer's hope is attained and the extent to which his growth costs actually enter into the equilibrium price depends on the strategy and timing of activities by the imitators. If some of them elect, as they frequently do, to use price competition (which they can readily do since they have lower marketing costs), the pioneer may have difficulty in recovering his growth costs; and these then do not enter into long-run price equilibrium.

To the extent that such growth costs do enter into equilibrium price and are borne by society, they may be regarded as part of the price of economic progress. For without some protection for these costs pioneers would be fewer and the opportunities for investment would be more scarce. When all the imitators follow the leaders' policies, however, and do not elect to use price competition, then the cost paid by society for progress may be too high.

B. The evidence of the study indicates that advertising has the effect of slowing up the development of price competition but that it rarely succeeds in preventing price competition over longer periods.

1. Price competition commonly reasserts itself in periods of depression, though it is clear that many businessmen delay too long in reducing prices at such a time.

2. Competing firms carry on a continual contest for advantage, and this rivalry takes many forms which are in lieu of price competition (e.g., special concessions, favors, rebates, and so on), but which ultimately break out in the form of price competition.

3. In many industries the large scale of operations made possible in part through advertising has resulted in reductions in costs, which frequently have been passed on in considerable part to consumers.

C. Advertising in general operates in the direction of increasing price stability and, to some extent, lessens the flexibility of the price system.

D. In some industries advertising has contributed to concentration of demand and hence has been a factor in bringing about concentration of supply in the hands of a few dominant firms, a situation which, according to the doctrine of imperfect competition, tends to keep prices at unduly high levels. The preponderance of evidence, however, indicates that advertising is not a basic cause for the concentration of supply in the hands of a few concerns.

IV. The Effects of Advertising on Quality and Range of Merchandise

A. Advertising tends to improve the quality and range of merchandise offered to consumers.

1. Advertising and aggressive selling have led to a more rapid adoption of new major inventions than would otherwise have been possible.

2. Advertising has played an indirect but nevertheless real and important part in stimulating product improvement, because it has brought about com-

petition in product improvement for the sake of developing selling arguments. Although some people believe that in the short run this type of competition results in product differentiations that are trivial or foolish, it is through numerous small developments over a period of time that major product improvements ultimately take place; and in a free society it is only through trial and error in the market that the seller can know whether a differentiation is significantly important to the consumer.

3. In addition to stimulating product improvement, advertising has had a desirable effect on product quality through the stimulus which it offers to the maintenance of quality of products sold under advertised brand names.

B. Because nonprice competition has had these important effects on the improvement in quality and range of merchandise. it cannot be dismissed as a socially undesirable form of competition.

V. The Effect of Advertising on Consumer Choice

A. Advertising and aggressive selling have had their most direct and important influence on consumer choice in widening the range of merchandise available to consumers, particularly through product differentiation. It is sometimes objected that these product differentiations are not significant ones for consumers; but in economics the worth-whileness of product differentiations must be determined in the end by consumers' behavior.

B. Significant product differentiations for the consumer are those things which give him satisfaction. He expresses his judgment of them by buying or refusing to buy. Evidence of the study indicates clearly that consumers accept some differentiations and not others. Over a long period, competition in product differentiation leads to significant improvements in products.

C. The main task of advertising for business concerns is to make sales mutually satisfactory to buyers and sellers at low cost, but there is evidence that advertising, as now practiced, is not giving consumers sufficient product information to serve as a wholly effective guide to consumer choice.

D. Nevertheless advertising has been the principal source of information available to consumers, and thus, in spite of inadequacies, has been essential to the functioning of the economy.

E. The inadequacy of information furnished by advertising has justified the development of the Consumer Movement in so far as the aims of that movement are to provide greater information and educate consumers to be better buyers.

F. The evidence suggests that in some situations consumers do not have enough opportunity to buy goods at low prices; and that where such options are available consumers either are not sufficiently aware of them, perhaps because of lack of advertising, or else, being aware, they do not choose to avail themselves of these options.

VI. The Effect of Advertising on Investment and the Level of National Income

A. Advertising and aggressive selling have been significant forces in advancing the technology of production and increasing the investment in productive facilities—two developments which largely explain the four-fold increase of real national income per capita during the past one hundred years.

1. From a long-range point of view, advertising and aggressive selling have played a very large though not precisely measurable part in the formation of mental attitudes necessary to a high level of consumption, especially such attitudes as expectation of change and the notion of progress. In other words, advertising has helped to develop a mobile as opposed to a static society.

2. Advertising has stimulated new wants with the result that the luxuries of one generation have become the necessities of the succeeding generation.

3. The possibility of using advertising and aggressive selling to bring businesses more quickly into the profit-making zone has facilitated the performance of the entrepreneurial function.

4. Advertising and aggressive selling have speeded up technological change.

5. Advertising and aggressive selling have had their greatest influence on investment in new industries, though they have also helped to increase the demand for the products of established industries.

B. The gains from new investment in plants to produce new products and from investment in labor- or capital-saving machines are not all net gains to the consumer group, since the new plant causes obsolescence of the old. But such losses from obsolescence should not be overemphasized. In spite of losses and dislocations that have occurred in the process of change and growth, the balance in terms of real consumer income and rising standards of living appears to rest in favor of change.

VII. The Effect of Advertising on Business Cycles

A. Advertising may slightly accentuate the swings of cyclical fluctuation in business.

1. The evidence indicates that the volume of advertising expands during a boom and contracts during a depression.

2. Businessmen make relatively little attempt to use advertising to offset cyclical movements.

B. Far-sighted business management might be able to employ advertising effectively in launching new products to combat cyclical down-swings. Some managements have done so.

C. There is no convincing evidence that advertising and aggressive selling constitute a cause of cyclical fluctuations.

1. It is true that advertising is probably one of the contributory causes to lack of flexibility in price structure. This inflexibility is found in both upward and downward price movements.

2. But the argument which makes such lack of flexibility in the price structure a significant cause of cyclical fluctuations is not well supported.

D. The "bullish" point of view typical of the entrepreneur who makes substantial use of advertising and other aggressive selling devices is essential to the revival of private investment needed for business recovery in any period of depression.

VIII. Principal Dangers in the Contemporary Use of Advertising

A. There is a tendency among businessmen to assume too readily that demand is inelastic and consequently to refrain from sufficient use of price as a competitive weapon.

B. Consumers sometimes do not have sufficient freedom of choice to buy nonadvertised or privately branded goods on a price basis.

C. In some instances, owing to the dominating position of large advertisers there may be insufficient freedom of entry of new enterprises into established industries.

D. The advance in distribution costs may be reaching the point where greater than corresponding declines in production costs are no longer forthcoming, and where the conveniences and services associated with present-day distribution may be proving too expensive a luxury for some pocketbooks.

E. Present-day advertising does not give consumers sufficient information to enable them to buy with full economic effectiveness.

IX. Important Counterbalancing Forces

A. A substantial number of firms elect to compete on a price basis.

1. Many small manufacturers cater to the demands of private branding distributors and therefore sell at low prices.

2. A considerable number of large companies also make up merchandise for sale under private brands.

3. There has been a substantial growth of strong distributive enterprises, such as chain stores, which sell private brands to a considerable extent on a price basis and which pit their strong buying power (and sometimes their own manufacturing facilities) against the monopolistic tendencies of some manufacturers. This development has done much to keep the situation in balance.

4. New types of enterprise in the distributive field usually elect to compete on a price basis, e.g., supermarkets.

B. The growing influence of the Consumer Movement through its emphasis on price as related to objective product qualities tends to offset in part the practice of some advertisers to lay heavy stress on appeals to emotion and instinct.

C. Efforts of businessmen to reduce wastes in advertising and selling through the use of improved techniques of market study, budgeting, and measurement of advertising results operate in the direction of lightening the burden of cost carried by consumers.

X. Final Conclusions on the Economic Problem

On balance, the general conclusion to be drawn from the evidence is that the functional objectives of advertising in a dynamic economy are socially desirable and that advertising as it is now conducted, though certainly not free from criticism, is an economic asset and not a liability.

GENERALIZATIONS ON THE ETHICAL PROBLEMS OF ADVERTISING

I. The use of influence in commercial relations is one of the attributes of a free economy. Therefore the ethics of advertising is the ethics of influence in the buyer and seller relationship.

II. In a competitive system where numerous sellers compete for the patronage of buyers the appropriate ethics for the seller are the ethics of the advocate. In other words, the seller's biased point of view is not inherently unethical.

III. As advertising and aggressive selling have developed, ethical standards governing their use have evolved on a pragmatic basis.

A. In this pragmatic evolution of ethical standards for advertising, certain advertising practices have come to be regarded as sufficiently serious abuses to be condemned by law, e.g., the so-called model advertising statutes which have been enacted in twenty-five states with the support of the advertising profession.

1. It is to be expected that crystallization of the views of the community into rigid statutes should lag somewhat behind the evolution of these community opinions.

2. Occasionally the law lags too far behind the sentiment of the community; such a situation probably existed for several years prior to 1935. But since that date the lag has been very substantially narrowed by the enactment of such measures as the Copeland amendments to the Pure Food and Drug Act, the Wheeler-Lea amendments to the Federal Trade Commission Act, and the Wool Labeling Act. It will take time to make these laws fully workable and overcome the administrative problems; and for that reason further major crystallizations into law of the ethical sense of the community with respect to advertising do not appear desirable for the time being.

a. The evidence from reports both of the Federal Trade Commission and of the Better Business Bureaus points to the conclusion that a relatively small percentage of present-day advertising material is of such a character as to be misleading or false under the definitions used by those organizations.

B. Going beyond the crystallizations in the form of law are the tentative formulations of the ethical sense of the business community represented by codes of professional conduct of various organizations, such as the code promulgated by the National Association of Better Business Bureaus.

C. But present-day advertising practice of some concerns falls short of these standards, since the latter represent tentative formulations which the public opinion of the community is not yet strong enough to enforce.

IV. In addition to observing ethical standards codified into law or sanctioned by the business community, advertisers should also give close heed to the sentiments of the consuming public, since these sentiments are likely to be significant indicators of newly developing crystallizations of community ethics. In this connection a survey of consumer opinions of advertising undertaken as part of this general study yielded the following significant results:

A. These consumers generally expected advertising to be biased.

B. But they had little tolerance for anything regarded as untrue, though they were somewhat lenient in their interpretation of what was true and what was false.

C. They possessed a fairly strong belief that advertising should be strictly true and purely informative.

D. They criticized a considerable body of advertising on the score of exaggerated claims, bad taste, use of fear, and use of questionable testimonials.

E. On the whole they apparently had somewhat better opinions of advertised products than of the advertising of the sponsors of those products.

F. A majority of them apparently believed that advertising increases prices.

In conjunction with other studies of consumer views on advertising, this survey suggests that with respect to certain advertising practices at least part of the business group may be lagging dangerously behind the sentiments of the consuming public.

V. On the other hand, business cannot raise standards much more rapidly than the general community will accept them; and the public, in spite of the opinions which it makes known in surveys, still accepts, and by its acceptance makes profitable, business practices which many businessmen would prefer not to employ but whose use by a minority forces the majority to fall in line.

SUGGESTIONS

Apart from the present emergency of national defense the problem of both business and government is how to keep the economic machine functioning, and from a practical standpoint that means functioning within the general structure of the private enterprise system. Very few people in business, in government, or in the community at large desire to see drastic social changes. But if such changes are to be avoided and if the economic machine is to be made to function effectively, it is necessary that businessmen, instead of being blindly antagonistic to all criticism, should become more acutely aware of the social consequences of their business acts and should seek to understand such criticisms of existing business practices as those which are dealt with in this study of advertising.

This study shows that advertising properly carried out contributes to the maintenance of a dynamic economy and helps to raise the level of real income. The functioning of advertising along these lines, however, can be substantially improved if businessmen will study their problems more carefully and make better use of price strategy. The existing economic machine can also be made to run more smoothly if businessmen will behave more boldly and fearlessly in pushing pioneering ventures and in keeping the door open to new types of enterprise. Efforts to choke off the entry of new enterprises, whether by means of patents, tying agreements, enormous advertising expenditures, or restrictive price control measures, such as price maintenance laws and not-selling-below-cost laws, will lead to the eventual disruption of the private enterprise system.

Businessmen can help consumers by providing more product information. It is short-sighted of businessmen to oppose the development of a strong Consumer Movement. Under a free-enterprise system consumers have fully as much right to organize as does labor. Furthermore, the Consumer Movement is one of the corrective forces which keeps the economic machine in proper balance.

Advertisers are in some danger of not paying sufficient attention to public sentiment. The practitioners of advertising have developed some interesting research techniques to find out what people like in advertisements and to find out what they like about products. It might be wise to use such types of opinion survey to keep in closer touch with evolving ethical standards by finding out what the public really thinks about many contemporary practices in advertising. There is a need to get at the facts instead of replying to criticisms by means of emotional statements based on half-truths, because such replies serve only to encourage further emotional statements based on partial truths by the other side.

The same admonition may be addressed to the critics of advertising. They are urged to examine the facts collected in this study, because an effort has been made impartially to appraise advertising and aggressive selling practices. The economists are urged to understand the organic functions of advertising in a dynamic economy. If this view of the function of advertising in a system of private enterprise is sound, advertising has a permanent place in modern life; and both the critics and the practitioners must work together to make advertising and aggressive selling serve even more effectively than in the past in the interests of the whole of society.

ADVERTISING AS A FACTOR IN DISTRIBUTION

NATURE OF ADVERTISING

Advertising is a firmly established and effective means of appealing to consumer interest and thereby of selling goods. It is used to introduce new products and to maintain consumer interest in established products and brands. In introducing a new product it may present to the consumer an entirely new or more economical means of satisfying wants. Its effect, when used to publicize a particular manufacturer's product or a particular merchant's business, may be merely to shift consumer demand from one brand to another or from one merchant to another without increasing the total volume of goods sold.

Advertising may be informative, truthful or deceptive, attractive or repulsive, and when used to excess by all manufacturers or distributors of a particular product, or by makers or distributors of substitute products, its effect may be to increase distribution expenses which must either be borne by the consumer through higher prices or by the advertisers through diminution of profits. On the other hand, manufacturers of, or dealers in, a new product may attract the public demand to this product to such an extent that production costs may be radically decreased.

Advertising may be participated in by an industry group or trade association

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Source: Excerpt from *Report of the Federal Trade Commission on Distribution Methods and Costs*, Part V (Washington, D.C., U.S. Government Printing Office, 1944), pp. vi–xiv, 7, 10–15.

to promote the products of the industry or group, as, for example, advertising campaigns of the dairy or meat industries, or individual manufacturers and trades may keep their names before the public, as during the present war, when they have limited quantities or even no products to sell to the civilian public. For some products advertising expenditures are an important factor in distribution costs, and for others such expenses are small. In many cases the individual advertiser is uncertain as to the effectiveness of his advertising.

The advertising expenditures of manufacturers, wholesalers, and retailers comprise an important item in cost of distributing many commodities, provide the income which supports advertising agencies, and are an important source of income for most magazines, newspapers, and the radio. Advertising expenditures also are the principal source of income for trade, class, and specialty publications.

IMPORTANT TYPES OF ADVERTISING

Appeal to the purchaser, which is the primary objective of all advertising, takes various forms. The individual manufacturer is interested in featuring his own branded products or in featuring the use of his products in the form in which they leave the factory, or in articles manufactured therefrom. Groups of manufacturers may cooperate to promote the sale of the products of an entire industry.

Wholesale and retail advertising generally is directed at attracting trade to the individual advertiser; and price, style, quality, service, and business integrity are paramount in their advertising. Widely and favorably known manufacturers' brands are frequently featured as price leaders.

Manufacturers frequently enter into agreements with retail dealers, through which they share with the dealer the cost of manufacturer-approved advertising. This type of advertising is assuming increasing importance in many industries. Wholesale distributor-controlled brands frequently are advertised to the consumer in ways similar to those used by brand-owning manufacturers. Retail chains, department stores, and some individual merchants also feature their own brands, by name and price, in their advertising.

The numerous types of advertising and other sales promotion range from paid advertising by radio or in magazines, newspapers, trade papers, house organs, billboard displays, and other specialty displays to the packaging of goods, store displays, combination deals, and house-to-house or other distribution of free samples.

WIDE DIFFERENCES IN ADVERTISING COSTS

The amounts spent in advertising per dollar of sales vary widely in different industries and different trades. In general, the cost is largest in certain lines of consumer goods such as drugs and cosmetics and food specialties and smallest for heavy chemicals, semifinished products, and durable capital goods. The amounts spent in advertising per dollar of sales also vary widely with trade customs and the degree of competition for trade among producers of different lines of products and even with respect to products in a single line.

CONSUMER INTEREST IN ADVERTISING

The consumer's interest in advertising is twofold. First, he may be influenced by advertisements to spend money for a new product or to substitute product A for product B in his purchasing. His second interest centers on whether the price paid for advertised products purchased is higher than it would be if advertising were less extensive or if some other form of distribution expense were substituted for it. This he can never exactly know. The consumer's principal means of checking lies in a comparison of prices at which he can buy extensively advertised brands and the prices at which he can purchase goods of a similar quality that are less extensively advertised or not advertised at all. This checking may be rendered wholly inaccurate if the nationally advertised brands are being advertised and sold by distributors as leaders at prices that do not cover the distributor's cost of goods and distribution expenses. In such a case, the highly advertised product may be selling to certain consumers at a price lower than the prices at which less extensively advertised competing brands of like quality are sold.

Advertising cost as related to the prices paid by the consumer is a combination of the advertising done by manufacturers or processors and by wholesale and retail distributors. The extensive sums expended for advertising enable the publishers of newspapers and magazines to charge a much lower price for their publications and also enable the radio to furnish the general public entertainment and news service that otherwise would not be possible.

Like other competitive devices, advertising is susceptible of use as a means of unfair competition. Advertising allowances granted to wholesale or retail dealers may be the means of discriminating in price between different classes of customers. Advertising allowances granted by a single manufacturer to a favored few hard-bargaining customers tend to spread to other customers and to be adopted by other manufacturers until the entire industry or trade [is] involved. In many lines these so-called cooperative advertising allowances fall into one of three principal types:

1. Contribution of a specified amount per unit, by the manufacturer and by each of his dealers, to a joint fund for local advertising, which fund is closely supervised by the manufacturer, as in the automobile industry.

2. Allowance by the manufacturer of a specified percentage of the amount of purchases, to some or all dealers, which is to be applied to cover a portion of the dealers' advertising that features the manufacturer's products. This plan is used by such industries as household electrical appliances, certain food products, and cosmetics.

3. Allowance by manufacturers of trade-marked materials to selected industrial users of their products and to retail distributors to cover an agreed-upon portion of the costs of advertisements featuring the products and services of all companies contributing to the cooperative advertising. This plan is used by certain branches of textile industries, beginning with the yarn producer and including subsequent processors and retailers.

IMPORTANCE OF ADVERTISING

According to statistics of the United States Bureau of the Census, the number of advertising agencies increased 34.3 per cent in the 5-year period from 1935 to 1939, and the receipts for their services increased 37.5 percent during that period. The amount of receipts was $70,840,000 in 1935 and $97,372,000 in 1939. These amounts represent only the income of advertising agencies for developing and placing advertisements for their clients.

Publishers' Information Bureau reports that 401 large advertisers expended more than a quarter of a billion dollars in advertising during 1941. The total amount expended by 2,549 manufacturing corporations reporting to the Commission in 1940 was $483,503,000. The aggregate sales of these 2,549 corporations was $25,864,135,000; and their average expenditures for advertising, 1.87 cents per dollar of sales. In addition, there are the sums spent by smaller manufacturing corporations and by wholesale and retail merchants.

ADVERTISING COSTS PER DOLLAR OF SALES

In 1940 the advertising expenditures of 2,716 manufacturing corporations in 91 industry and subindustry groups ranged from a minimum of six one-hundredths of [one percent of] a dollar of sales for the shipbuilding industry to a maximum of 13.94 cents out of the manufacturers' sales dollar for drugs and medicines. The manufacturers' per dollar of sales costs of advertising in 1940 were as follows:

Group	Number of Manufacturer Industry Groups
Under ¼ of a cent	11
¼–½ cent	14
½–1 cent	17
1–1½ cents	9
1½–2 cents	13
2–2½ cents	9
2½–3 cents	4
3–4 cents	4
4–5 cents	2
5–10 cents	4
10–14 cents	4

In 1940 shipbuilding, crude petroleum producing, merchant pig-iron manufacturers, copper smelters and refiners, and cane-sugar refiners were the five industry groups with the lowest advertising, with beet-sugar processors ranking sixth in lowness of advertising per dollar of sales. The range for the lowest five being from six one-hundredths to seventeen one-hundredths cents per dollar of sales. At the upper range were drugs and medicines, highest, followed by cereal preparations, cigarettes, soaps and cooking fats, and distilled liquors, with malt beverages ranking sixth from the highest. The range of the five highest was from 13.94 cents to 9.79 cents per dollar of sales. Motor-vehicle manufacturers, whose advertising is conspicuous in peacetimes, was only slightly higher than the average for 2,549 corporations in 1940, namely, 1.94 cents per dollar of sales compared with the average of 1.87 cents.

ADVERTISING MEDIA

An analysis of the proportion of the amount spent by 548 corporations, whose advertising expenditures, in 1939, aggregated $71,498,607, for 17 industries, showed the following percentages:

Radio	18.3%
National magazines	17.4
Newspapers	15.2
Miscellaneous	13.3
Material furnished dealers	13.0
Outdoor posters	7.3
Joint advertising	6.4
Letters, folders, mailed by manufacturer	5.7
Trade journals	2.6
Indoor posters	0.8

The only media used by more than half of the companies were letters and folders, part of which were mailed direct and the remainder furnished dealers. Although expenditures for radio advertising exceeded the cost of all other media, only one company out of four used the radio.

The 17 industries were manufacturers or processors of meats, canned foods, cereals, flour, biscuits and crackers, coffee, women's dresses, women's hosiery, men's and boys' suits, men's shirts, carpets and rugs, lumber, cement, paints and varnishes, farm machinery, gasoline and lubrication oil, and rubber goods.

There was a wide difference in the proportion of the different advertising media used by different industries in 1939. For example, national magazines, newspapers, and letters and folders furnished dealers, combined, accounted for 72.1 percent of the advertising of meat processors; 30.3 percent of the expenditures of processors of canned goods were for advertising in national magazines; 54.9 percent of the money spent by manufacturers of cereals and 44.6 percent of that expended by flour millers was for radio advertising; biscuit and cracker manufacturers allotted 30.8 percent and coffee processors 33.8 percent to newspaper advertising; women's dress manufacturers expended 54.9 percent of their advertising expenditures through national magazines; manufacturers of men's suits 47.4 percent, carpet and rug manufacturers 53.8 percent, and farm machinery 33.2 percent, through national magazines; lumber manufacturers expended 48.3 percent of their advertising budget in trade magazines; while women's hosiery makers, cement manufacturers, gasoline and lubricating oil manufacturers, and makers of rubber goods distributed a considerable proportion of their advertising through several media.

WHOLESALER'S ADVERTISING

Four hundred and thirty-nine wholesalers, with net sales of $439,215,815, spent $1,552,094 for advertising in 1939. The average expenditure per dollar of sales for the 10 lines of trade was thirty-five hundredths of a cent, ranging from a minimum of only three one-hundredths of a cent for wholesalers of men's and boys' clothing to 1.08 cents for paint and varnish wholesalers. The costs per dollar of sales for the 10 wholesale trades were:

Trade	Cents per Dollar of Sales
Paints and varnishes	1.08
Petroleum products	0.88
Tires and tubes	0.59
Cooperative grocery	0.30
Old line grocery wholesalers	0.26
Lumber	0.23
Carpets and rugs	0.18
Women's clothing	0.17
Men's and boys' clothing	0.03

ADVERTISING BY RETAILERS

Based upon the Commission's sample, advertising expenditures by retail dealers are larger in relation to net sales than for wholesalers and also represent a larger part of the total distribution cost. This is especially true for a number of commodities, such as men's and women's clothing, electrical household products where manufacturers share part of the cost of local advertising with retailers handling their products.

Data for 1,527 retailers handling nine different lines of products with aggregate sales of $481,156,224, in 1939, spent $6,823,402 on advertising, or an average of 1.42 cents of each sales dollar. The lowest expenditure was fifty-nine one-hundredths of a cent per dollar of sales for lumber; and the highest, 4.33 for women's clothing. The costs per sales dollar were as follows:

Commodities	Cents per Dollar of Sales
Women's clothing	4.33
Men's clothing	3.61
Carpets and rugs	2.53
Electric household appliances	2.53
Paints and varnishes	1.59
Petroleum products	1.37
Tires and tubes	1.28
Groceries:	
Independents	0.73
Chains	0.66
Lumber	0.59

Based upon their total distribution costs, advertising expenditures absorbed from 2.39 percent in the case of retail lumber dealers and 12.66 percent, or one-eighth, for women's clothing stores.

COOPERATIVE ADVERTISING

In a number of industries the manufacturer shares with the retail dealer, and sometimes also with manufacturers and processors, the cost of local advertising. One of the many contract requirements of several motor-vehicle manufacturers provided that the retailer contribute a specific amount per new car to an advertising fund to which the manufacturer also contributed a specific amount per new car sold. Motor-vehicle manufacturers either expended this fund for national and local advertising or expended a part of it in national advertising and closely supervised the expenditure of the balance in local advertising placed by the dealer. The amounts contributed by dealers varied with the prices of different makes of cars. In some cases the dealer contributed a specified amount per car, while in other cases he contributed a specified percentage of the manufacturer's list price of each car sold.

In the farm-machinery industry, the promotion of sales by the manufacturer usually takes the form of exhibits and working demonstrations in cooperation with retailers, because farmers are strongly influenced in their buying by the results of demonstrations, comparisons of construction, and exchanges of experience among owners. As in the motor-vehicle business, both large and small farm-machinery manufacturers print booklets, leaflets, and other consumer advertising, which are furnished to their dealers for distribution.

For motor-vehicle tires and tubes, the cooperation between manufacturer and dealer generally takes the form of providing printed advertising matter, assistance in the preparation of local advertising, and, for about two-thirds of the companies, making allowance for a part or all of the cost of local advertising done by the dealer.

Approximately one-half of the household electrical-appliance manufacturers reporting to the Commission stated that they share with the dealers the expense of local advertising, and one-fifth did it by granting special price allowances in consideration of advertising done by dealers. Electrical-appliance manufacturers also provide their dealers with printed advertising and sales promotion material, and many of them assist dealers in the preparation of advertising and displays. Some of the companies provided the services of demonstrators to work with retailers.

Paint and varnish manufacturers furnish their dealers with materials such as booklets, leaflets, color cards; some assist dealers in the preparation of window and counter displays; and approximately one-third aided their dealers in local advertising, and about the same proportion reimbursed some or all of their dealers for a part or all of the cost of advertisements which featured the manufacturer's brands. In some cases advertising expense of the dealer is shared by special price allowances in consideration for advertising placed by the dealer, but the principal method appears to be sharing in the preparation and space cost of local advertising.

Petroleum refiners generally provide their dealers with printed advertisements, booklets, road maps, and leaflets, and approximately one-third reported assisting dealers in the preparation of local advertising and displays. Only about one-fifth of the companies bore any part of local advertising expense placed by the dealers, and only 2 of the 42 companies compensated their retail dealers by giving them special price allowances in consideration for advertising placed by the dealers.

In the men's and boys' clothing industry, only a small proportion of the companies contribute to local advertising by retail dealers. Some manufacturers assisted their dealers in the preparation of local advertising matter, and most of them provide booklets, leaflets, and other printed matter for dealer use. The situation with respect to manufacturers of men's shirts and collars is practically the same as that for men's clothing.

In women's dresses, some designers and cutters join with selected retailers in promoting advertising and display of their garments, although the number who assist dealers is relatively small in comparison with the total number of manufacturers. Some furnish selected dealers with the services of demonstrators and pay part of the cost of dealer advertising featuring their identified products.

A new form of trade advertising appearing in recent years in the clothing industry is that of trade associations of manufacturers joining with unions representing the labor they employ in promoting the use of labels on garments indicating the city or manufacturing area in which the goods originated. This is an effort to popularize particular producing areas as the sources of style goods much as "Made in Paris" has been used in the past.

The overlapping of interests of brand-conscious manufacturers has given rise to a type of advertising which features the trade-marks or trade names of the several interested manufacturers and retailers in advertisements which appear in trade and fashion magazines, newspapers, and other advertising media. In some cases this is done entirely by the retailer who wishes to avail himself of the good will and prestige attaching to widely known trade-marks and names of manufacturers whose products are used in the goods he sells, but particularly in fashion magazines sometimes this type of advertising is at the expense of a nationally advertising yarn or fabric manufacturer who desired to reach the consumer in advertisements which announce that his products are used in the manufacture of clothing by well-known garment manufacturers which may be purchased in certain specified large retail stores. In other instances, the yarn or fabric manufacturer may share the costs of advertising in fashion magazines or local newspapers with garment manufacturers who subsequently use his products, or with retailers who handle the ultimate garments, or all three may participate in the cost of local advertising. The garment manufacturers or retailers selected are usually companies well known among consumers, and their names are featured in the advertisements.

In the women's hosiery trade, a considerable portion of hosiery manufacturers join with retailers in order to obtain special dealer support and promotion of their particular brands. A relatively large proportion of hosiery manufacturers assist in the preparation of local dealer advertising and window displays, provide printed dealer advertising helps, and reimburse dealers either by paying a specified percentage of the cost of advertisements or by giving special price allowances in consideration of advertising done by the dealer.

Rayon manufacturers, generally, maintain that it is necessary to create a demand for their product by developing a demand for products fabricated from rayon yarn. To stimulate the use of rayon yarn, they joined with garment manufacturers and with retailers in bearing the cost of advertising which featured garments made from their product. The cost of this cooperative advertising became so burdensome that, in 1939, at a conference of rayon producers and a committee of weavers, the principal rayon producers, except one, agreed to discontinue sharing any of the cost of advertising with retail distributors, cutters, converters, or weavers. Later, a second rayon manufacturer began to share advertising costs with processors and distributors; as a result, two types of advertising are now in use in the rayon manufacturing industry. Under one plan the manufacturer features garments made of rayon in his advertising and names garment makers and well-known distributors who use his product, and under the other advertising plan allowances are granted by the rayon manufacturer to users of the rayon yarns and to the larger retailers handling clothing made from his product.

ECONOMIC EFFECTS OF COOPERATIVE ADVERTISING

Manufacturers are divided in their opinions with respect to cooperative advertising. Many who have used it condemn it because it has become burdensome in their industries. Others commend it, claiming that it enables them to gain more active sales efforts from retailers receiving advertising allowances and that such retailers incline consumers to prefer articles made from cooperating manufacturers' products. As already indicated, cooperative advertising arrangements exist respecting trade-marked goods as dissimilar as automobiles, household electrical appliances, certain processed foods, clothing, cosmetics, and household remedies. Some are expensive articles purchased infrequently, while others are low-priced commodities frequently purchased by the consumer. In a given trade, the tendency is for manufacturers, in the clothing line, for example, to give advertising allowances for higher priced rather than low-priced clothing. On the other hand, the practice has existed in the bread trade.

Sixty large department and specialty stores, located in all parts of the country, reported several hundred commodities for which the manufacturer granted advertising allowances. The extent of the practice is indicated by the fact that the 60 stores listed 145 cosmetic manufacturers, 61 corset and brassiere manufacturers, and 60 makers of dresses, sweaters, and sport garments, as granting advertising allowances.

Administrative difficulties and overhead expense may be involved if a manufacturer grants advertising allowances to all of his retailers on proportionally equal terms. Placing a minimum limit on the amount of purchases on which advertising allowances are given automatically excludes small retailers and may well adversely affect them in competition with their financially stronger competitors.

The competitive effects of cooperative advertising are not confined to the retail trade. It has its effects upon competition among manufacturers. The first manufacturer to grant an advertising allowance to a large and well-established retailer soon experiences demands from other retailers for an allowance, and, similarly, competing manufacturers are urged, sometimes on threat of loss of trade, by retailers for allowances. When cooperative advertising becomes the general practice in an industry, some, at least, of its benefits are lost by the companies first adopting it, and the industry may find itself with an excessive expenditure for advertising.

Granting advertising allowances by the manufacturer to some, but not all of his dealers, and granting allowances on different bases to dealers of different sizes, may lay the basis for those who do not receive any allowances or dealers who do not receive them on the same basis as competitors, to claim that the practice is unfair and discriminatory. Such complaints have been made to the Federal Trade Commission, and on March 16, 1942, a cease-and-desist order was issued against Corn Products Refining Co. which involved, among other things, discriminatory use of cooperative advertising. The company appealed the case, and on July 6, 1944, the United States Circuit Court of Appeals for the Seventh Circuit handed down a decision fully supporting the Commission's action with respect to cooperative advertising.

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ADVERTISING IN RELATION TO NET SALES

[Table 1 shows] the percentage of each sales dollar for advertising for 91 commodity groups in 1940.

[Table 2 shows] the relative importance of advertising and selling expenses for each of 91 important industry groups in 1940.

[Table 3 shows advertising as a percentage of total advertising, selling, and delivery expense for 91 industry groups in 1940.]

Table 4 gives a detailed analysis of the advertising expenditures of 548 manufacturers grouped by commodities. The table shows the number of companies in each commodity group reporting the use of specified types of advertising and the percentages of total advertising spent for each type.

Table 5 assembles data from Table 4 to show the types of advertising that represented the 5 largest items of advertising expenditure for each of the 17 commodity groups.

TABLE 1

ADVERTISING PER DOLLAR OF NET SALES FOR 91 INDUSTRY GROUPS IN 1940

Industry	Number of Companies Covered	Advertising
Shipbuilding	16	0.06%
Crude petroleum	17	0.08
Merchant pig iron	10	0.15
Copper smelting and refining	13	0.16
Cane-sugar refining	17	0.17
Beet-sugar manufacturing	14	0.21
Bolts, nuts, washers and rivets	33	0.21
Lumber and timber products	77	0.21
Textile dyeing and finishing	27	0.22
Steel castings	39	0.24
Tanned, curried and finished leather	37	0.24
Aircraft manufacture	25	0.26
Iron and steel forgings	32	0.26
Lead and zinc products	30	0.28
Match manufacturing	9	0.28
Gray and malleable iron castings	217	0.30
Woolen and worsted manufacturing	44	0.32
Clay products (except pottery)	22	0.33
Railroad equipment	32	0.33
Electric wire and cable	34	0.33
Screw machine products	23	0.36
Lead and zinc primary smelting	17	0.39
Coke oven products	7	0.40
Power boilers, etc.	19	0.40
Cotton textiles	56	0.46
Machine-tool accessories	29	0.52
Oil field machinery	23	0.58
Tin cans and tinware	9	0.61
Machine tools	40	0.64
Steam engines and turbines	5	0.66
Plastics manufacturing	19	0.77
Paper and pulp	150	0.79
Fertilizer manufacturing	23	0.80
Mining machinery and equipment	27	0.81
Cement	23	0.87
Rayon and allied products	14	0.87
Industrial chemicals	33	0.89
Plumbers' supplies	16	0.89
Automobile parts and accessories	64	0.90
Textile machinery	49	0.95
Special industry machines	98	0.96
Sewing machines	8	0.98
Elevators, escalators and conveyors	22	1.04
Hardware	35	1.06
Mechanical stokers	9	1.07
Milk and milk products	122	1.10
Cranes, dredges and road equipment	29	1.11
Glass and glassware	22	1.25
Petroleum refining	40	1.25
Agricultural machinery and tractors	20	1.33
Internal-combustion engines	13	1.33
Food-products machinery	23	1.50

TABLE 1 (*Continued*)

Industry	Number of Companies Covered	Advertising
Water-softening equipment	19	1.55%
Gypsum products	9	1.57
Electrical machinery and apparatus	49	1.58
Asbestos and abrasive products	32	1.59
Furniture	71	1.59
Footwear (except rubber) sold through own stores	10	1.60
Pumps and air compressors	20	1.61
Firearms and ammunition	12	1.68
Men's and boys' clothing—sold direct to wearer	3	1.70
Smelting and refining equipment	7	1.72
Commercial laundry and dry cleaning	6	1.84
Motor vehicles	23	1.94
Corn products	11	2.00
Footwear (except rubber) sold to non-affiliated distributors	28	2.00
Refrigerators and air conditioning equipment	21	2.02
Rubber products	29	2.07
Paving and roofing materials	18	2.08
Mechanical measuring equipment	10	2.17
Heating and cooking apparatus	39	2.20
Wool carpets and rugs	21	2.30
Paint, varnish and lacquer	40	2.46
Biscuits and crackers	7	2.60
Blowers and exhaust fans	10	2.62
Bread and bakery products	82	2.63
Office and store machines	20	2.63
Flour milling	22	3.03
Wallboard, building insulation and floor composition	15	3.45
Men's and boys' clothing—sold to trade	21	3.60
Linoleum and hard-surface floor coverings	10	3.67
Men's and boys' clothing—sold through own stores	5	4.20
Fruit and vegetable canning	49	4.49
Cigars	12	5.40
Tobacco products	6	8.20
Malt beverages	41	8.97
Distilled liquors	14	9.79
Soaps and cooking fats	20	10.94
Cigarettes	10	11.30
Cereal preparations	14	13.08
Drugs and medicines	20	13.94

TABLE 2

ADVERTISING AND SELLING EXPENSE PER DOLLAR OF NET SALES FOR 91 INDUSTRY GROUPS IN 1940

Industry	Advertising	Selling and Delivery	Total Advertising, Selling and Delivery
Crude petroleum	0.08%	0.32%	0.40%
Shipbuilding	0.06	0.64	0.70
Merchant pig iron	0.15	1.23	1.38
Copper smelting and refining	0.16	1.36	1.52
Aircraft manufacture	0.26	1.47	1.73
Iron and steel forgings	0.26	2.53	2.79
Railroad equipment	0.33	2.56	2.89
Rayon and allied products	0.87	2.07	2.94
Lead and zinc products	0.28	2.75	3.03
Coke oven products	0.40	2.80	3.20
Textile dyeing and finishing	0.22	3.02	3.24
Lead and zinc primary smelting	0.39	3.23	3.62
Tin cans and tinware	0.61	3.10	3.71
Tanned, curried and finished leather	0.24	3.53	3.77
Cotton textiles	0.46	3.41	3.87
Gray and malleable iron castings	0.30	3.58	3.88
Woolen and worsted manufacturing	0.32	3.56	3.88
Automobile parts and accessories	0.90	3.24	4.14
Electric wire and cable	0.33	3.85	4.18
Bolts, nuts, washers and rivets	0.21	4.23	4.44
Machine-screw products	0.36	4.30	4.66
Steam engines and turbines	0.66	4.10	4.76
Cane-sugar refining	0.17	4.62	4.79
Steel castings	0.24	4.77	5.01
Motor vehicles	1.94	3.29	5.23
Paper and pulp	0.79	4.49	5.28
Lumber and timber products	0.21	5.18	5.39
Machine tools	0.64	5.72	6.36
Power boilers, etc.	0.40	6.09	6.49
Firearms and ammunition	1.68	4.82	6.50
Textile machinery	0.95	5.64	6.59
Industrial chemicals	0.89	6.10	6.99
Fertilizer manufacturing	0.80	6.23	7.03
Glass and glassware	1.25	6.36	7.61
Machine-tool accessories	0.52	7.28	7.80
Plumbers' supplies	0.89	6.93	7.82
Clay products (except pottery)	0.33	7.92	8.25
Corn products	2.00	6.26	8.26
Internal-combustion engines	1.33	7.16	8.49
Elevators, escalators and conveyors	1.04	7.75	8.79
Plastics manufacturing	0.77	8.34	9.11
Oil field machinery	0.58	8.61	9.19
Mechanical stokers	1.07	8.16	9.23
Flour milling	3.03	6.22	9.25
Mining machinery and equipment	0.81	8.53	9.34
Hardware	1.06	8.38	9.44
Wool carpets and rugs	2.30	7.21	9.51
Cement	0.87	8.83	9.70
Men's and boys' clothing—sold to trade	3.60	6.40	10.00

TABLE 2 (*Continued*)

Industry	Advertising	Selling and Delivery	Total Advertising, Selling and Delivery
Footwear (except rubber) sold to non-affiliated distributors	2.00%	8.40%	10.40%
Furniture	1.59	8.85	10.44
Refrigerators and air-conditioning equipment	2.02	8.45	10.47
Special industry machines	0.96	9.60	10.56
Electrical machinery and apparatus	1.58	9.13	10.71
Smelting and refining equipment	1.72	9.07	10.79
Gypsum products	1.57	9.62	11.19
Cranes, dredges and road equipment	1.11	10.25	11.36
Fruit and vegetable canning	4.49	6.87	11.36
Agricultural machinery and tractors	1.33	10.79	12.12
Linoleum and hard-surface floor covering	3.67	8.78	12.45
Blowers and exhaust fans	2.62	9.91	12.53
Cigars	5.40	7.40	12.80
Water-softening equipment	1.55	11.46	13.01
Beet-sugar manufacturing	0.21	12.81	13.02
Match manufacturing	0.28	12.75	13.03
Paving and roofing materials	2.08	10.97	13.05
Milk and milk products	1.10	12.44	13.54
Petroleum refining	1.25	12.51	13.76
Asbestos and abrasive products	1.59	12.20	13.79
Rubber products	2.07	12.20	14.27
Pumps and air compressors	1.61	12.71	14.32
Heating and cooking apparatus	2.20	12.63	14.83
Mechanical measuring instruments	2.17	13.15	15.32
Food-products machinery	1.50	14.01	15.51
Paint, varnish and lacquer	2.46	13.33	15.79
Footwear (except rubber) sold through own stores	1.60	14.20	15.80
Cigarettes	11.30	4.60	15.90
Wallboard, building insulation and floor composition	3.45	13.00	16.45
Tobacco products	8.20	10.60	18.80
Cereal preparations	13.08	5.77	18.85
Commercial laundry, dry cleaning and pressing equipment	1.84	17.51	19.35
Soaps and cooking fats	10.94	8.89	19.83
Men's and boys' clothing—sold direct to wearer	1.70	18.50	20.20
Distilled liquors	9.79	10.52	20.31
Malt beverages	8.97	15.70	24.67
Men's and boys' clothing—sold through own stores	4.20	20.90	25.10
Biscuits and crackers	2.60	23.23	25.83
Bread and bakery products	2.63	24.24	26.87
Drugs and medicines	13.94	13.41	27.35
Office and store machines	2.63	26.72	29.35
Sewing machines	0.98	35.55	36.53

TABLE 3

ADVERTISING AS A PERCENTAGE OF TOTAL ADVERTISING, SELLING, AND DELIVERY EXPENSE FOR 91 INDUSTRY GROUPS IN 1940

Industry	Advertising
Beet-sugar manufacturing	1.61%
Match manufacturing	2.15
Sewing machines	2.68
Cane-sugar refining	3.55
Lumber and timber products	3.90
Clay products (except pottery)	4.00
Bolts, nuts, washers and rivets	4.73
Steel castings	4.79
Power boilers, etc.	6.16
Oil field machinery	6.31
Tanned, curried and finished leather	6.37
Machine-tool accessories	6.67
Textile dyeing and finishing	6.79
Screw-machine products	7.72
Gray and malleable iron castings	7.73
Electric wire and cable	7.89
Milk and milk products	8.12
Woolen and worsted manufacturing	8.25
Men's and boys' clothing—sold direct to wearer	8.42
Plastics manufacturing	8.45
Shipbuilding	8.57
Mining machinery and equipment	8.67
Office and store machines	8.96
Cement	8.97
Petroleum refining	9.08
Special industry machines	9.09
Lead and zinc products	9.24
Iron and steel forgings	9.32
Commercial laundry, dry cleaning and pressing equipment	9.51
Food-products machinery	9.67
Cranes, dredges and road equipment	9.77
Bread and bakery products	9.79
Machine tools	10.06
Biscuits and crackers	10.06
Footwear (except rubber)—sold through own stores	10.13
Copper smelting and refining	10.53
Lead and zinc primary smelting	10.77
Merchant pig iron	10.87
Agricultural machinery and tractors	10.97
Hardware	11.23
Pumps and air compressors	11.24
Fertilizer manufacturing	11.38
Plumbers' supplies	11.38
Railroad equipment	11.42
Asbestos and abrasive products	11.53
Mechanical stokers	11.59
Elevators, escalators and conveyors	11.83
Cotton textiles	11.89
Water-softening equipment	11.91
Coke-oven products	12.50
Industrial chemicals	12.73
Steam engines and turbines	13.86

TABLE 3 (*Continued*)

Industry	Advertising
Gypsum products	14.03%
Mechanical measuring instruments	14.16
Textile machinery	14.42
Rubber products	14.50
Electrical machinery and apparatus	14.75
Heating and cooking apparatus	14.83
Paper and pulp	14.96
Aircraft manufacture	15.03
Furniture	15.23
Paint, varnish and lacquer	15.58
Internal-combustion engines	15.66
Smelting and refining equipment	15.94
Paving and roofing materials	15.94
Glass and glassware	16.42
Tin cans and tinware	16.44
Men's and boys' clothing—sold through own stores	16.73
Footwear (except rubber)—sold to non-affiliated distributors	19.23
Refrigerators and air-conditioning equipment	19.29
Crude petroleum	20.00
Blowers and exhaust fans	20.91
Wallboard, building insulation, and floor composition	20.97
Automobile parts and accessories	21.74
Wool carpets and rugs	24.18
Corn products	24.21
Firearms and ammunition	25.85
Linoleum and hard-surface floor covering	29.48
Rayon and allied products	29.59
Flour milling	32.76
Men's and boys' clothing—sold to trade	36.00
Malt beverages	36.36
Motor vehicles	37.09
Fruit and vegetable canning	39.52
Cigars	42.19
Tobacco products	43.62
Distilled liquors	48.20
Drugs and medicines	50.97
Soaps and cooking fats	55.17
Cereal preparations	69.39
Cigarettes	71.07

TABLE 4

NUMBER OF MANUFACTURERS REPORTING THE USE OF SPECIFIED TYPES OF ADVERTISING AND PERCENTAGES OF TOTAL ADVERTISING EXPENDED FOR EACH TYPE BY 548 MANUFACTURERS, GROUPED BY COMMODITIES, 1939

Item	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets
	Foods											
	Meats		Canned Foods		Cereals		Flour		Biscuits and Crackers		Coffee	
Total companies reporting	27		40		21		42		12		20	
Total advertising reported	$3,270,398		$3,272,969		$9,398,938		$5,204,595		$3,086,194		$1,577,495	
Advertising media used:												
Trade journals	8	2.4	17	2.0	9	0.5	19	2.6	4	1.5	10	0.4
National magazines	6	24.9	9	30.3	8	9.2	6	12.6	4	14.2	8	0.4
Newspapers	21	23.8	21	7.1	17	15.2	28	8.1	11	30.8	13	33.8
Indoor posters	1	0.4	4	4.6	1	1.8	3	0.5	2	3.2	4	0.4
Outdoor posters	13	3.9	5	3.1	5	0.2	11	2.2	4	11.9	11	6.7
Radio	12	8.5	15	5.5	13	54.9	16	44.6	8	10.5	14	28.3
Letters, folders, etc., mailed	9	0.9	11	3.4	9	1.3	15	0.8	2	0.8	9	4.8
Letters, folders, etc., for dealers	22	23.4	13	8.0	13	4.2	18	7.9	3	5.7	13	4.2
Joint advertising with dealers	11	3.9	10	9.8	12	3.5	18	12.2	3	0.4	13	10.1
Other forms of advertising	12	7.9	15	26.2	16	9.2	25	8.5	8	21.0	13	10.9
Total	..	100.0	..	100.0	..	100.0	..	100.0	..	100.0	..	100.0

TABLE 4 (*Continued*)

Item	Clothing and Carpets									
	Women's Dresses		Women's Hosiery		Men's Suits		Men's Shirts		Carpets and Rugs	
	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets
Total companies reporting	17		8		58		11		7	
Total advertising reported	$158,127		$651,059		$2,572,341		$1,131,617		$1,135,878	
Advertising media used:										
Trade journals	7	5.2	4	2.2	25	3.7	5	2.7	6	10.0
National magazines	7	54.9	4	21.9	13	9.3	4	44.9	4	53.8
Newspapers	3	13.9	4	15.6	21	47.4	3	9.1	1	*
Indoor posters	..	....	..	....	2	0.1				
Outdoor posters	..	....	..	....	1	0.9	1	0.2		
Radio	1	0.1	1	0.7	7	6.7				
Letters, folders, etc., mailed	7	6.9	3	12.0	41	13.9	4	0.4	3	5.9
Letters, folders, etc., for dealers	6	8.6	6	22.1	18	9.3	9	26.7	5	17.6
Joint advertising with dealers	4	3.6	5	22.0	7	1.2	4	10.2	2	2.8
Other forms of advertising	5	6.8	3	3.5	16	7.5	2	5.8	3	9.9
Total	..	100.0	..	100.0	..	100.0	..	100.0	..	100.0

* Less than 0.05 percent.

TABLE 4 (*Continued*)

Item	Building Materials						Other Commodities					
	Lumber		Cement		Paints and Varnishes		Farm Machinery		Gasoline and Oil		Rubber Goods	
	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets	Companies Reporting	Percent of Total Budgets
Total companies reporting.......	34		52		113		42		29		15	
Total advertising reported.......	$266,382		$475,953		$3,439,823		$4,580,485		$20,154,515		$11,121,837	
Advertising media used:												
Trade journals...............	31	48.3	14	16.7	55	7.9	24	3.0	20	2.0	14	1.8
National magazines...........	8	27.9	13	12.8	26	7.6	23	33.2	17	11.9	8	24.7
Newspapers.................	9	1.7	21	4.5	52	7.8	11	0.1	23	20.1	10	6.9
Indoor posters..............	..	....	1	0.1	3	0.2	1	0.5	8	0.3		
Outdoor posters.............	1	*	7	1.8	43	3.9	4	0.1	26	19.4	10	3.1
Radio......................	2	0.3	..	....	19	4.7	9	3.1	15	15.6	10	7.0
Letters, folders, etc., mailed...	10	1.8	22	21.1	76	13.1	34	14.0	18	6.0	12	6.6
Letters, folders, etc., for dealers	8	9.9	33	22.7	79	19.7	30	26.4	22	12.9	13	15.4
Joint advertising with dealers..	6	4.4	6	0.9	42	7.3	10	0.7	14	2.3	6	16.7
Other forms of advertising.....	7	5.7	23	19.4	38	27.8	18	18.9	18	9.5	10	17.8
Total....................	..	100.0	..	100.0	..	100.0	..	100.0	..	100.0	..	100.0

* Less than 0.05 percent.

TABLE 5

TYPES OF ADVERTISING THAT WERE THE 5 LARGEST ITEMS OF ADVERTISING EXPENDITURE OF 548 MANUFACTURERS GROUPED, BY COMMODITIES, 1939

Type of Advertising	Largest Expenditures		Second Largest Expenditures		Third Largest Expenditures		Fourth Largest Expenditures		Fifth Largest Expenditures	
	Commodity Group	Per cent of Total Spent	Commodity Group	Per cent of Total Spent	Commodity Group	Per cent of Total Spent	Commodity Group	Per cent of Total Spent	Commodity Group	Per cent of Total Spent
Magazine	Meats	24.9	Flour	12.6	Cereals	9.2	....	....	Cement	12.8
	Canned foods	30.3	Lumber	27.9	Biscuits and crackers	14.2	....	....	Gasoline and oil	11.9
	Women's dresses	54.9	....	....	Women's hosiery	21.9				
	Men's shirts	44.9	....	....	Men's suits	9.3				
	Carpets and rugs	53.8								
	Farm machinery	33.2								
	Rubber goods	24.7								
Radio	Cereals	54.9	Coffee	28.3	Gasoline and oil	15.6	Meats	8.5	Biscuits and crackers	10.5
	Flour	44.6	....	....	....	....	....	....	Farm machinery	3.1
									Rubber goods	7.0
Newspapers	Biscuits and crackers	30.8	Meats	23.8	....	....	Women's hosiery	15.6	Canned foods	7.1
	Coffee	33.8	Cereals	15.2	....	....	Men's shirts	9.1	Flour	8.1
	Men's suits	47.4	Women's dresses	13.9	....	....	....	....	Paints and varnishes	7.8
	Gasoline and oil	20.1								
Folders, etc., for dealers	Women's hosiery	22.1	Men's shirts	26.7	Meats	23.4	Canned foods	8.0	Cereals	4.2
	Cement	22.7	Carpets and rugs	17.6	Women's dresses	8.6	Men's suits	9.3		
			Paints and varnishes	19.7	Lumber	9.9	Gasoline and oil	12.9		
			Farm machinery	26.4	....	....	Rubber goods	15.4		
Trade journals	Lumber	48.3	....	....	Carpets and rugs	10.0	Cement	16.7		
							Paints and varnishes	7.9		
Miscellaneous forms of advertising			Canned foods	26.2	Coffee	10.9	Cereals	9.2	Meats	7.9
	Paints and varnishes	27.8	Biscuits and crackers	21.0	Cement	19.4	Flour	8.5	Women's dresses	6.8
			Rubber goods	17.8	Farm machinery	18.9	Carpets and rugs	9.9	Men's suits	7.5
							Lumber	5.7	Men's shirts	5.8
Joint advertising with dealers					Canned foods	9.8	Coffee	10.1	Lumber	4.4
	....	....	Women's hosiery	22.0	Flour	12.2				
					Men's shirts	10.2				
					Rubber goods	16.7				
Letters, folders, etc., mailed			Men's suits	13.9	Paints and varnishes	13.1	Women's dresses	6.9	Women's hosiery	12.0
	....	....	Cement	21.1	....	....	Farm machinery	14.0	Carpets and rugs	5.9
Outdoor posters	....	....	Gasoline and oil	19.4	....	....	Biscuits and crackers	11.9	Coffee	6.7

ADVERTISING BRANDED PARTS TO CONSUMERS[1]

BY NEIL H. BORDEN

Over the next few years one of the interesting phases of the battle of the brands undoubtedly will be an effort by many manufacturers of fabricated materials and parts used in consumer's goods, especially by manufacturers of new and improved products for such use, to build a reputation for their brands at the ultimate consumer level. In so doing they will of course be advertising and promoting their brands among persons who buy not the fabricated materials and parts as such but rather the finished goods in which those materials and parts are incorporated. Their objective will be to influence their actual customers, the manufacturers of the finished goods, to use their particular branded materials and parts in place of those which either are less well known or are not labeled at all.

When is an attempt to promote a branded fabricated material or part to ultimate consumers good business strategy? What are some of the guiding principles by which to judge the likelihood of success in such efforts? An attempt will be made in this article to give at least partial answers to these questions through an analysis of company experiences observed over the years.

In recent decades the instances of consumer advertising and promotion of brands by manufacturers of fabricated materials and parts have been many, and from this source come quite a few of our well-known brand names. To cite a partial list, there are: in textiles, Nylon, Lastex, Forstmann, Stroock, Botany, Celanese, Crown, Pepperell, and Bemberg; in metals, Armco, Monel, Alcoa, and U.S. Steel; in bearings, Timken, SKF, Hyatt, and New Departure; in electric motors, General Electric, Westinghouse, Lincoln, and Western Electric; and in divers fields, Fisher (automobile bodies), Bendix (automotive parts), Talon (fasteners), Belden (electric cords), New Departure (bicycle brakes), Sanforized (preshrinking process), and Ethyl (antiknock compound).

Although a complete list of such brands advertised to ultimate consumers would be long, a similarly complete list of fabricated materials and parts sold either unbranded or without promotion of brand at the ultimate consumer level would be far longer. In fact, it is certain that only a small proportion of the total volume of fabricated materials or parts is identified for ultimate con-

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Source: *Harvard Business Review*, Vol. XXV, No. 1 (Autumn, 1946), pp. 129–144. Reprinted by permission.

[1] Author's Note: Many of the points made and case histories referred to are treated in the author's *Problems in Advertising* (New York, McGraw-Hill, 1937), and *The Economic Effects of Advertising* (Chicago, Irwin, 1942).

In 1945 the National Industrial Conference Board, Inc., issued an interesting and valuable report by G. Clark Thompson on *Creating Good Will for the "Hidden Product"* (Studies in Business Policy, No. 11), which discusses at some length the subject of Consumer Identification Plans for fabricated materials and parts. In a sense, this article is a more detailed analysis of certain aspects of brand promotion of the type of product discussed in that report.

sumers. This conclusion seems well founded when one considers the great range of consumer products into which are incorporated fabricated materials and parts that have no identification. For instance, the yarn or the cloth in the great majority of garments is not identified; nor is the metal in most finished products containing metal; nor are the leather, soles, eyelets, or welting in shoes; nor are most of the parts in automobiles or household appliances which are supplied to final goods manufacturers by parts producers; and so on.

On what basis do some manufacturers of fabricated materials and parts attempt to identify their brands among consumers when so many others do not?

Basic Objectives

As is true in brand promotion of any kind, the fabricated materials manufacturers who advertise to consumers seek thereby to get as much control as possible over the demand for their products. By inducing finished goods manufacturers to adopt and identify their particular branded materials or parts in finished products, they hope to create, each for himself, a larger and more stable market than is to be had when reputation is limited to the manufacturing trade alone. Their plan of attack is far more aggressive, of course, than the customary procedure of directing selling and promotional efforts only to manufacturing customers, thus leaving ultimate users unaware of the materials or parts included in the finished products.

But why does brand promotion to consumers help such companies sell to finished goods manufacturers? The answer to this question stems from the basic fact that the salability of finished goods into which the well-known material or part is incorporated can thus be enhanced. This point is well illustrated by the case of the Fisher Body Company. Because that company's own sales are assured by its position as a General Motors subsidiary, the promotion of its brand is clearly designed with no other object than to help sell the finished product in which the brand is identified—in other words, to build a reputation which the various General Motors automobile companies using Fisher bodies can trade upon in the sale of their cars. Such a reputation was especially desirable for Chevrolet in the days when General Motors was trying to establish the car in the low-price field. Chevrolet had come into the General Motors fold with the reputation of having a good motor but a poor chassis and body; consequently Chevrolet advertising made great play of "Body by Fisher."

It is, of course, this effect on salability of finished goods which a manufacturer of fabricated materials or parts utilizes to further his immediate objective—that is, to increase the salability of his own product. Indeed, if his customers can be led to believe that they will increase their sales by using his well-known branded part or material, they may be inclined to do so even when the cost is higher than for a competing material or part of similar quality but without the same consumer recognition. Moreover, it is possible, at least for the short run, that even though the salability of finished goods is not actually affected by the use of a particular branded material or part, so long as a finished goods manufacturer can be led to think that it is, the promotion of the brand has served its purpose.

Yet there are strong reasons why a finished goods manufacturer will not wish to trade on the reputation of a branded part unless the case for so doing is very convincing. For one thing, identification of the part in his product commits him to its continued use, and he sacrifices in some degree his independence in selecting or in switching his sources of supply. Moreover, he may well prefer to build among consumers of his finished products a reputation which is solely his. Not infrequently a manufacturer of fabricated materials and parts who seeks to build a brand reputation among ultimate consumers has met such understandable resistance among finished goods manufacturers. They have accepted the advertised brand and traded on its reputation only when convinced that such action brought them enough advantage in the way of greater salability to outweigh the disadvantages of losing their autonomy.

In view of such probable resistance, the important questions faced by the manufacturer of fabricated materials and parts when he considers advertising and aggressive promotion of his brand are two: (1) Do I have a good basis for establishing a sales-enhancing reputation for my branded material or part? (2) Will I be able, in the long run, to recoup the costs of building this reputation, which may be large, through greater sales or higher prices or a combination of the two?

STRATEGY OF PROMOTION

These questions really reach the heart of our problem. Before we can set up guiding principles to help in answering them, however, we must have a clearer picture of the elements of promotional strategy ordinarily involved.

COORDINATED SELLING EFFORTS

As a rule, magazine advertising to ultimate consumers is made the spearhead of the brand promotion. This advertising almost invariably is of an indirect-action type; that is, it does not seek any immediate response or any action from the consumer except, perhaps, his writing the advertiser for a booklet of some kind. The objective of the advertisements, as is true with most brand advertising of manufacturers, is to build brand reputation—to make the brand familiar to consumers and to build mental associations about the brand that may be conducive to consumer acceptance or preference at time of purchase.

Experience indicates that generally the manufacturer should have little expectation that his advertising will lead to a consumer insistence or preference strong enough to bring requests or inquiries from among retailers for products containing the branded part. Accordingly, he should not expect to sit back and wait for his advertising to set up a simple chain of action wherein the consumer asks the retailer for a finished product containing the branded material or part; the retailer then requests the manufacturer to supply his product so constructed; and the finished product manufacturer thereupon seeks out the material or parts advertiser as his source of supply. There are very few cases where more than a trickle of consumer inquiries has developed. In other words, there is need for additional types of sales promotion to secure the desired results.

A parallel may be drawn from the brand advertising of finished consumer goods. When manufacturers of finished consumer products advertise, they generally count on buying action coming largely as the result of coordinated promotional efforts. A few products, such as proprietary remedies which play upon powerful buying motives, are "pulled through" the channels of trade by advertising, but most articles also require some "pushing" at the point of purchase. A few consumers may actually ask for a brand advertised in an indirect-action advertisement, but most consumers buy when they see the product displayed in a store or when retailers suggest the article. Not until there is such a buying stimulus subsequent to the time of the advertisement do the mental associations built around brands by indirect-action advertising ordinarily play their part. Herein lies the importance of well-coordinated programs of promotion.

Similarly, selling campaigns to establish brands of fabricated materials or parts must call for well-coordinated advertising and selling efforts directed at all who might have an influence on the merchandising of finished goods containing the part or material. Indeed, the manufacturer of fabricated materials and parts can expect even less than the finished goods manufacturer in the way of consumer inquiries at retail stores. Until retailers stock products whose labels make known that the products contain a branded material or part, the brand-reputation advertising of the material or part has no chance at all to demonstrate whether it has built a strong consumer preference, or even ready acceptance. Accordingly, it is necessary for the manufacturer of the fabricated material or part to persuade finished goods manufacturers to use and identify his product on the ground that the consumer reputation established by the advertising makes such action worth while—in other words that the brand reputation will be conducive to consumer purchase of the finished product when it is displayed in such a way as to identify the fabricated material or part.

In short, the fabricated goods manufacturer ordinarily has to proceed at first without appreciable evidence of actual consumer preference for finished goods equipped with this product—only a basis for such preference, namely, a well-known brand name. Yet, counting on the general belief among businessmen that it is valuable for a product to be well known, the material or parts manufacturer can use the fact of his advertising and aggressive promotion as additional appeal in behalf of his product. Almost invariably his sales presentation to his prospective customers has as an important element the argument that the reputation built by advertising is an important reason for buying his material or part and that buyers can profit from this reputation by including that part in their products and trading upon it. And this appeal may be strong, as pointed out earlier, whether the fact of increased salability to consumers can be demonstrated conclusively or not—although of course it will tend to lose its strength if the long-run sales trend of the finished goods manufacturers fails to respond.

PROMOTION AMONG RETAILERS

In most instances a substantial part of the promotional program is directed to retailers as well as to consumers. For many products, particularly textiles and shoes, retailers play an important role in directing and shaping consumer attitudes. Moreover, as immediate customers of finished goods manufacturers, their attitudes and preferences may have considerable influence upon the merchandising and product design of finished goods manufacturers. In fact, in a few product fields, such as shoes, retailers actually specify to some extent the materials to be used in their orders. Thus, whenever the retail trade has been an important influence in merchandising, the fabricated parts and materials manufacturers, in addition to their consumer advertising, not only have directed substantial advertising campaigns to retailers in trade papers, but also have carried on substantial personal missionary work among them. An instance will illustrate.

In the late 1920's the Graton & Knight Company, which manufactured belting, sought to secure a wide adoption of its Spartan sole leather for shoes. This was a special tannage originally developed for the company's belting but found to be especially suitable for sole leather in children's shoes, for it had great flexibility, long life, high water resistance, light weight, and the characteristics of drying out soft and pliable after wetting. The company made Spartan soles identifiable by tattooing gold spots into the leather.

Wide adoption of Spartan shoes by shoe manufacturers was hindered by the fact that the price was approximately 20% higher than that for ordinary sole leathers. Therefore, knowing that shoe retailers often specified the leather to be used in shoes they bought, Graton & Knight prepared an aggressive campaign of newspaper advertising directed to ultimate consumers, seeking to use the consumer reputation thus established to get retailer interest and specification of Spartan soles in their orders of shoes. It was felt that even a small demand from consumers at retailers' stores would be effective in inducing the retailers to specify Spartan soles. Along with this consumer campaign, the company carried through an intensive campaign of trade paper advertising and missionary work among retailers in 13 leading city markets. In the approach to retailers, the company sought retailer tie-in advertising among those carrying shoes made with Spartan soles. At the same time this dual consumer and trade drive was made the core of a sales drive on shoe manufacturers, carried out through the sales force and in various advertising media. Manufacturers were urged not merely to adopt the soles but to make them a feature of their own promotion and advertising.

Note the elements of the company's coordinated program: (1) The sole leather was marked so that it might be identified in shoes. (2) By advertising to consumers the company sought to do what it could to induce consumer inquiry at retail shoe stores, thus arousing retailer interest; and, more generally, to build a reputation which would increase the salability of shoes equipped with Spartan soles. (3) Advertising and personal selling was directed to the retailers to increase their interest in Spartan soles and to get them to specify these soles in their orders to shoe manufacturers; retailers were also urged to use Spartan soles as a promotional feature in their selling and advertising, thus identifying the material or parts brand with the finished product brand. (4) The shoe manufacturers were urged by salesmen and advertisements to adopt Spartan soles as a means of increasing the sale of their shoes, and the advantage of using Spartan soles as a promotional feature in their selling was presented to them.

It should be emphasized that we are not here citing cases as examples of what should or should not be done in the circumstances related, but only as examples of what *was* done. As a matter of fact, the Graton & Knight attempt was unsuccessful, for reasons which will be discussed later; it nevertheless serves as a pertinent illustration of coordinated selling efforts—and serves also as a warning that the task of establishing a market for branded materials and parts depends on far more than good promotional strategy.

Remember that the Graton & Knight Company was operating in a field where retailers were influential. For most products, however, retailers do not have their orders made up especially for them or are not otherwise in a position to specify materials or parts in their buying. Accordingly, manufacturers of branded materials or parts do not ordinarily expect to have retailers demand their products in ordering. Instead they count on the less tangible fact that retailers' interest in the part or material, expressed in discussion with salesmen of the finished goods manufacturers and perhaps also showing up in the way they buy, will have at least some influence toward adoption of the branded material or part.

Limitation of Promotion

This role of retailers, as distinct from ultimate consumers, suggests another and more narrow type of promotional strategy. There are some manufacturers who have limited their promotional approach to the trade (usually the retail trade but sometimes the wholesale trade also, where that enters the picture) rather than trying to reach the whole way to consumers in their sales programs. For instance, a rubber wire company, which had developed an improved, flexible, rubber-insulated wire cord, in the early 1920's carried on a campaign to wholesalers and retailers for its improved wire with the objective not only of influencing their direct purchases of cord for repair and replacement purposes but also of building a brand reputation among them that would be helpful in inducing appliance manufacturers to equip their appliances with the cord. In this case the company did not wish to spend the sums required for advertising to consumers and concluded that building brand reputation in the trade was adequate to accomplish its objective. As part of a coordinated program, then, the advertising and personal selling directed to appliance manufacturers dwelt on dealer knowledge of the improved cord and dealer preference for it as reasons for its original use on appliances. This campaign is in contrast to that of the Belden Manufacturing Company which with the same objective extended its promotional efforts in behalf of its electrical cord the whole way to consumers.

Another example is that of a New England manufacturer of elastic goods who undertook a program of aggressive advertising of its Hub brand of goring (an important element in shoe manufacture). In this instance, according to the judgment of company executives the reputation established through this trade advertising helped the company to attain a dominating position in the sale of goring to shoe manufacturers.

In the textile industry also there are numerous instances of promotion limited to retailers. So-called converters, who dye and finish textiles for sale to the garment manufacturers, frequently carry on advertising in *Women's Wear Daily* and other trade papers, urging retailers in buying garments to specify their particular brand of finishing in order to insure consumer satisfaction with fabrics. Thus the United Piece Dye Works in the early 1930's addressed a campaign to retailers on "The Woman Who Never Came Back" (since she was dissatisfied with a garment that failed to wear well because of faulty finish). The company sought to induce garment manufacturers to put a tag on their garments saying, "The fabric in this garment was Dyed and Finished by United." Buyers in stores were advised to protect themselves by asking for "Finish by United." Another example is that of Tortal Broadhurst Lee Company, Ltd., which in 1943 advertised its Anti-Crease Fabrics and advised buyers to look for the patent number in the selvage in order to be sure of getting the "fundamentally new type of textile," which had an unusual resiliance.

An interesting variation is given in an instance related by Thompson in the National Industrial Conference Report cited earlier: The Celanese Corporation before the war included in its program the ingenious plan of issuing a buying guide in tabloid form for department store buyers and merchandise managers, illustrating garments made with Celanese yarn and listing the garment manufacturers who cooperated with the Celanese company in identifying their garments as made with Celanese yarn. Opportunity to appear in this guide was an additional reason for garment manufacturers to use Celanese materials and so mark the garments.

In general, experience shows that limiting advertising to the retail (and wholesale) trade and to finished goods manufacturers is indicated (1) when the trade traditionally has had an important part in influencing merchandising, and (2) when sales volume and margins have provided advertising and promotional funds inadequate to support an advertising program to consumers. Advertising to consumers is costly, whereas advertising to retailers and wholesalers in trade papers or by mail can make a substantial impact on the trade with a relatively small expenditure.

IDENTIFYING THE PART

Every promotional campaign to build the brand reputation of fabricated materials and parts, whatever its scope, must as an important part of its strategy enable the consumer to recognize the material or part as being in the finished goods when its identity otherwise would be hidden. Such identification contributes to spreading brand familiarity and reputation of the material or part, and it represents the commitment of finished goods manufacturers to that material or part that may well mean greater stability in sales.

The Graton & Knight Company put gold spots on its leather to identify it for consumers. Not all fabricated parts or materials can be identified in the finished products by any such imprint. The presence of a material or part can always be made known, however, by a label or tag. Moreover, since the objective of the advertising is to induce finished goods manufacturers and retailers to trade upon the reputation of the brand, a successful program will cause them to try to identify the material or part not merely by an attached tag or label but also in their advertising and personal selling. Indeed, cooperation by the finished goods manufacturers and by the retailers in identifying the material or part to the consumer is one of the criteria of success of such promotional plans.

By way of summary to this section, it can be said that many marketing programs of fabricated materials and parts manufacturers have advertising to consumers as the core of their promotional approach, and the advertising and personal selling directed to the trade and to finished goods manufacturers are built around the reputation established among consumers. While the strategy employed varies, it usually includes in some form most of the elements listed in the Graton & Knight case.

GUIDING PRINCIPLES

Now that the strategy usually followed to gain identification of fabricated materials or parts has been noted, let us see what guiding principles may be laid down to help in determining the wisdom of embarking upon such a program.

USEFULNESS FOR NEW DEVELOPMENTS

The desirability of undertaking consumer advertising of fabricated materials or parts may sometimes be indicated by the need of securing consumer acceptance of a new type of product. The task is not simply establishing brand acceptance, but gaining acceptance for a new product idea. A few instances will illustrate.

Outstanding in this area is the case of Talon fasteners, particularly as applied to use in men's trousers. The long-established custom of using buttons of closure on trousers and the hesitation to accept new ideas, so often found among consumers, led the management to expend substantial amounts on advertising in consumer magazines. In the early years the advertising was primary in character, stressing the advantages of improved appearance and greater convenience from use of slide fasteners as compared with button closure. Possible consumer objections and uncertainties regarding slide fasteners were answered. While the appeals were chiefly primary to get consumer favor for slide fasteners, the special merits of Talon were woven into the copy. In later years the competitive angle received greater emphasis.

Other advertising campaigns for fabricated material, which quite obviously were undertaken at least in part to break down consumer resistance to new products and to establish consumer acceptance therefor, were those of Monel

Metal, of Lastex, and of the various rayon yarns, Celanese, Bemberg, and Crown. Monel Metal was a new and unique alloy; making its characteristics known to consumers was undoubtedly an aid to its acceptance for various consumer uses. Similarly, Lastex, the elastic yarn manufactured by the United States Rubber Company, represented a new development which benefited from consumer popularization. Again, the suitability of rayon for garments had to be established among consumers. The last example has several additional points of interest.

In the 1920's rayon suffered from a bad reputation because textile companies did not know how to handle it and finish it, nor did consumers know how to launder and care for it in use. Accordingly, the rayon yarn manufacturers had a difficult educational job with textile manufacturers and an equally difficult educational job with consumers. In fact, the industry still suffers from lack of consumer knowledge of the use and care of rayon, and from the selling of poor products for which too much has been claimed. Over the years, the manufacturers of these yarns have striven to control the quality of textiles made in part or entirely of their yarns, to get identification of yarn brand in final garments, and to build about their brand names an aura of dependability in quality and beauty.

These are not isolated instances. In fact, an inspection of the well-known brand names of fabricated materials and parts shows that a substantial proportion were popularized by the advertising undertaken during the pioneering stage when the manufacturers were courting consumer acceptance for new and often radical product ideas. To the names mentioned there may be added: Nylon, the Bendix starter, Sanforized preshrinking process, Ethyl antiknock compound, Goodrich Koroseal, and Goodyear Airfoam and Pliofilm. For a number of these products their marketers have had the advantage of patents giving protection during a period when product and market developmental costs might be recouped. Certain of them have become so well known as to raise the danger that consumers would apply their brand names indiscriminately to similar products of other manufacturers, and the companies in question would lose their trade-mark rights (as was the case with DuPont's Cellophane). In some instances, the improvements over old materials offered to consumers have been so marked that after the introductory stage it has been relatively easy to obtain sales and to induce manufacturers to use the brand names on finished goods. This is true of Nylon in stockings, Lastex in girdles, Sanforized in garments, and Ethyl in gasoline.

We can therefore say: For a promising new type of fabricated material or part with a large enough market, consumer and trade advertising may be helpful tools to speed up acceptance of finished goods containing the material or part.

Filling a Real Consumer Need

Not all new products, however, can be put across in this way. Consider the case of a New England manufacturer of elastic webbing, who developed a patented cotton webbing with strands of exposed rubber woven through it to use as the curtain in men's trousers (the strip of fabric that goes around the inside top of the trousers). The exposed rubber strands were a nonslip device providing friction to keep men's shirts from working out and to keep trousers snug and neat at the waist.

The management found that there was great resistance to acceptance of the product by both clothing manufacturers for incorporation in clothing and by the trade for sale to consumers by the piece. Evidently neither manufacturers nor retailers were convinced that the product would be wanted by consumers. In fact, some feared consumers would be averse to the idea of a curtain containing exposed rubber. Thereupon the management, enthusiastic about the product as a result of limited tests among consumers, embarked upon an energetic campaign involving space in the *Saturday Evening Post* and trade papers and also substantial personal missionary work to retailers and clothing manufacturers. The purpose of the consumer advertising was to dramatize the problem of the bulgy shirt and to arouse a consumer interest and acceptance which would lead to manufacturer and trade cooperation.

The program failed to secure the consumer acceptance needed to induce finished goods manufacturers to use the material. Sales did not come. Many thousands of dollars were lost on the venture.

The failure of the elastic webbing appears to have been a failure of merchandise rather than of promotion. Like any invention or innovation, it had to prove itself with consumers. It had to meet some need, solve some consumer problem, give such satisfaction that it would be wanted and, specifically in this case, would make clothes containing it preferred to clothes without it. It may be argued, of course, that the company did not hold on long enough in its effort to educate the public, for education is slow and the pioneering stages for any new idea are likely to be discouraging. There is no certain answer to this argument, but a survey conducted subsequently indicated that the management had overestimated the importance of the bulgy shirt problem among customers.

Determination of success or failure for such advertising, as mentioned before, is not easy, for many factors influence the results of a company's selling program. Yet clearly this company's experience contrasts sharply with such a case as that of Talon fasteners, where the growing and continued use of slide fasteners for many purposes has justified the faith of the management in its article; or that of the manufacturers of rayon yarn, which rightly used has won consumer approval and become important in the textile industry.

A fundamental principle which should be recognized, then, by any fabricated material manufacturer who sets out to get consumer acceptance for a new type of product is to be sure of his merchandise. Does it fill a consumer need that can be developed into an active want great enough to justify the marketing risk involved? Advertising cannot put over a product that does not fill a real consumer need. This generalization is elemental, but some of the biggest losses of businesses come from improper appraisal of merchandising opportunity. To conduct a costly marketing program for a product that cannot succeed necessarily means loss.

BRAND DIFFERENTIATIONS

While a fair share of consumer advertising campaigns of fabricated materials or parts have been undertaken, as indicated above, to pave the way for consumer acceptance of new product ideas, many of the campaigns have been more selective in character, i.e., more competitive. Their aim has been to establish a brand reputation—to gain a consumer recognition for a material or part which is differentiated in quality from competitive products of the same type or class. Such, for instance, was the program for Spartan sole leather by Graton & Knight, and such has been the Talon program since slide fastener closures have become generally accepted. In addition to that of Talon are many other successful campaigns of this type—Armco iron; the various bearings, Timken, SKF, Hyatt, and New Departure; and various textiles such as Forstmann, Stroock, Botany, and Pepperell—all of which have been carried through largely by magazine advertising. Likewise, the stories of many products for which there were short-lived efforts to build brand reputation among ultimate consumers might be added to the Spartan experience—for instance Stormwelt, a welting for men's shoes, Diamond eyelets for shoes, and Drylea umbrella frames.

Unfortunately, in these competitive campaigns, even more than in campaigns to establish acceptance for new types of products, there are no clear-cut bases for saying how successful or how valuable the advertising and aggressive promotion have or have not been. In the cases of well-known brand names the aggressive brand promotion has evidently been helpful; the fact that the advertising has been continued shows that the managements have judged it to be worth while. Yet for the other products mentioned the promotion has seemed to be so ineffective relative to cost that it has been dropped. Let us look at a few of the cases in the latter category:

In the case of Spartan sole leather, the product evidently had characteristics making it preferable to many competing leathers and substitute materials, particularly for children's shoes. But the cost was 20% greater than for regular tannage. The question, then, was whether the differential in quality was worth the higher price. Unfortunately, the higher price operated against the product's adoption for use in children's shoes; in the case of children's shoes there usually are established price lines, and the manufacturers did not feel they could absorb the increased cost. But what about consumers; would they be willing to pay more than their customary price to get shoes equipped with Spartan leather? There is real doubt that, even if the campaign had been considerably (and expensively) prolonged, parents would have demanded adoption or expressed enough interest so that shoe manufacturers in large numbers could have been won over to the higher price leather.

In the case of Stormwelt (and of Diamond eyelets discussed subsequently) there was effort to influence a style acceptance of shoes containing the advertised brand of fabricated materials. In 1924 and 1925 the Barbour Welting Company advertised its patented Stormwelt for men's shoes. This was a new type welting with an exposed ridge similar to that in cork welting, which gave a distinctive appearance to shoes and sealed the inner seam, thus preventing moisture and dirt from penetrating between soles and top leather. It served also as a retaining wall to hold the shoe in shape. It was priced at 16 cents a yard, about three times the price of regular Goodyear welting. The management advertised this welting in the *Saturday Evening Post*, *Vogue*, *Vanity Fair*, and in trade papers. It also carried on aggressive selling efforts to shoe manufacturers in an effort to induce their adoption of Stormwelt because of consumer familiarity with the product resulting from the consumer advertising. *Vogue* and *Vanity Fair* were used, for example, to create the impression that shoes made with Barbour Stormwelt were fashionable. While the new Stormwelt had a considerable sale, particularly the first year, the company did not continue its advertising at the consumer level beyond two years. In other words, it was the management's judgment that the costs were too high for the results obtained by the venture.

This case appears to involve a product for which consumer advertising was questionable. In the eyes of consumers, welting is not an important element of shoes. It would be hard to convince consumers that one welting is greatly preferable to another; nor would they probably be greatly influenced in selecting shoes by presence of or lack of a particular welting. Likewise, the factor of resistance to penetration of dirt and moisture from use of Stormwelt would appear less significant, because dampness sooner or later penetrates through both soles and uppers of shoes.

Moreover, to push a special design of welting in an effort to influence the styling of men's shoes seems to be tackling an almost impossible job. While shoe manufacturers might offer a few items with a special welting as a feature, they would undoubtedly be inclined to make most of their styles conform to what was acceptable to consumers at the time; that is, they would confrom to fashion as it was. Even under more favorable circumstances, it is risky for one manufacturer to try to establish fashion through advertising.

In 1928 and 1929 the United Fast Color Eyelet Company advertised its Diamond eyelets in *Vogue*, *Vanity Fair*, *Town and Country*, *Harper's Bazaar*, *Spur*, and in trade papers, apparently to influence consumers and retailers to favor shoes with Diamond eyelets, which were high-quality visible shoelace eyelets. The demand for Diamond eyelets had fallen away because of adverse style trends. Moreover, for low-price shoes, visible eyelets of poorer quality than Diamond and inexpensive invisible eyelets appeared to be favored by manufacturers who sought to cut costs. The management in 1929 reported that sales increases had not resulted after the aggressive campaign, although apparently the decline in sales was temporarily checked. The consumer advertising was not continued, presumably because of the paucity of the results in relation to the costs incurred.

Just as in the case of Barbour Stormwelt, this effort to promote the eyelets to consumers and the trade as a means of influencing shoe manufacturers was probably doomed to failure from the start. On any rational appraisal of utility, the eyelet could not assume any appreciable importance in the eyes of consumers or the trade. Certainly, the company's idea that it could influence shoe fashions by what was after all a very modest consumer advertising program was questionable. Equally open to question was the thought that shoe manufacturers would be greatly influenced by the argument that a consumer style preference had been created by the company's limited advertising in the consumer fashion media.

The Drylea frame for umbrellas was advertised in 1924 in a small-space campaign in the *Saturday Evening Post* and in a few large city newspapers by the manufacturer, the Hartley Company. (Both product name and company name have been disguised.) This frame had a ball and socket action joint at the junction of the ribs that rendered it unusually durable. Moreover, the frame was rust-resistant and made so that it would not shear the covering. The frame had a narrow metal trade-mark attached to a rib to make it recognizable by consumers. In addition to direct consumer advertising, the company urged retailers not only to buy umbrellas made with Drylea frames but also to advertise their Drylea frame umbrellas with mats furnished by the company. As a further part of the campaign, the company attempted to persuade umbrella manufacturers both to manufacture their umbrellas with Drylea frames and to use that fact in their selling to retailers.

In undertaking this campaign, the company was influenced by the fact that S. Fox and Company in England, with the help of consumer advertising, had built a reputation among consumers in that country for Fox's frames that had evidently been valuable in gaining for the Fox company a leadership in the umbrella frame field. The Hartley Company found, however, that American umbrella manufacturers did not approve of its aggressive campaign for Drylea frames. Although the company did succeed initially in shifting a considerable part of its sales from the less costly frames it manufactured to the higher price Drylea frame, the reputation of the frame did not bring a substantial demand thereafter. When fashion switched its favor to umbrellas made with a Japanese type of frame, which was what happened at about that time, the rational appeals built around Drylea frames completely lost their effectiveness, and the company discontinued its campaign.

In this case the consumer and trade advertising appears to have had appreciable effect for a short time in inducing umbrella manufacturers to adopt the advertised frame. Even this temporary result appears somewhat surprising. In contrast to the situation in England, where people use their umbrellas a great deal and consequently take their umbrella purchases seriously, American consumers purchase umbrellas sporadically and apparently with little discrimination. Therefore, we might well doubt whether the reputation of frames would have great influence on the sale of umbrellas in this country. Yet, no matter how we may rationalize about the importance or lack of importance which American consumers attach to an umbrella frame, the Hartley Company had some success from its modest advertising expenditure. Umbrella manufacturers were influenced, perhaps illogically, until Dame Fashion, as she often does, spoiled the effect. Whether the campaign would have continued to be successful if fashion had been more propitious is another question.

In contrast to the above cases of failure or doubtful success, it has been possible for some manufacturers of fabricated materials to make their product differentiations important in the eyes of consumers through skillful merchandising and promotion, even when conditions might be expected to be somewhat against them. Their aggressive advertising and promotion to consumers and to the trade have clearly been helpful tools, not only in inducing finished goods manufacturers and the trade to use their brand names in the promotion of finished goods, but also in inducing the manufacturers to submit to a considerable degree of control in their own manufacture and promotion, imposed as a means of protecting the reputation of the fabricated material brand. As instances of such apparent success we may cite Forstmann woolens and Stroock woolens, two brands of textiles which have won high consumer recognition and preferment even though most consumers are likely to pay considerably less attention to the make of the fabric in the garments they buy than to other factors like color, cut, and so on.

These two brands of fabric go into expensive garments. Their reputation is based on the skill with which they are woven. In turn, the aggressive promotion of their products among consumers and the trade has established for their distinctive fabrics a reputation which makes garments containing their labels salable. Exclusive garment workers and exclusive retailers, in turn, have traded upon this reputation and thereby have added luster to it; and at the same time, the fabric manufacturers have succeeded in large degree in inducing garment makers and retailers to refrain from using the labels for special sales events and to be careful to remove the labels in clearances so that the fabric's reputation for distinctiveness and exclusiveness will not be injured.

What conclusion can be drawn from the cases cited? Unless the differentiation offered by the branded part or material is of some significance to consumers or can be made to appear significant through the advertising, then the efforts at building brand reputation through consumer advertising and missionary selling probably are unwise. Such a conclusion appears justified, for it is in keeping with the use of advertising and aggressive promotion generally. Brand advertising is a tool for promoting differentiated merchandise. When products are relatively standardized or the differences in quality are of no great significance to consumers, competition tends to turn to price. On the other hand, when the differentiation is, or appears to be, significant to consumers, then brand may assume importance, and advertising and other forms of nonprice competition may be the most profitable approach for a business firm.

In the case of fabricated materials and parts specifically, it likewise appears logical to say that if a differentiation offered by a brand is of no great significance to consumers, this fact is readily recognizable among finished goods manufacturers. Hence, they are likely to conclude that the brand familiarity built through advertising would contribute little to the salability of their finished goods, and they are not greatly influenced by sales presentations urging the brand.

ADEQUACY OF PROMOTION FUND

In the cases where consumer advertising has been dropped, it is probable that the costs of an aggressive approach to consumers relative to the sales which the companies could expect were deciding factors in leading the managements to discontinue the programs. This seems to be true in the cases of the Graton & Knight Company, the Barbour Welting Company, and the United Fast Color Eyelet Company. Clearly it holds in the case of Hartley Company with its Drylea umbrella frames; the small sales of the company could only provide for advertising and promotion a sum woefully inadequate for the job to be done.

In contrast, fabricated materials and parts companies with large sales volume have been in a position to support sizable advertising campaigns to consumers even when their products have not appeared to offer enough significant differentiation to justify higher prices. The burden of promotion cost per unit or dollar of sale has been small for such companies. They have evidently deemed the reputation to be sufficiently helpful in their selling to finished goods manufacturers to justify the expenditures. For instance, the American Rolling Mills for many years has advertised its rust-resisting Armco iron to consumers and has sought to get finished goods manufacturers to label their products as being made of Armco iron. The differentiation offered in this brand could hardly be highly significant to consumers or have great effect on the salability of products identified as containing it. Yet, the brand familiarity and the appeals made may well have some influence, even though small, on consumers and hence on finished goods manufacturers, so long as the price is in line with competing iron. In turn, even though the advertising expenditure is considerable, it is not large in light of the sales volume of the company.

Similarly, the various manufacturers of bearings have advertised to consumers. Presumably, there is no highly significant differentiation among leading makes of standard bearings. Yet bearings are an important part of any mechanism, and identification of a well-known brand in a machine is reassuring to a prospective purchaser. Moreover, the wide application of bearings and the resulting substantial volume of sales make the building of reputation at the consumer level not an unduly heavy burden for the large bearing manufacturers. The aggressive approach taken by Timken apparently has had sufficient sales value for the company to induce other bearing manufacturers to follow suit in their advertising and promotion.

Clearly, one of the determinants of success in undertaking a program of brand promotion at the consumer level is the size of the promotional fund available to carry on the campaign. If it is inadequate to provide the impact needed in influencing consumers, the trade, and finished goods manufacturers, or if a company cannot support the losses likely to be incurred in the developmental period, then it is questionable whether the aggressive approach should be undertaken.

Earlier discussion has indicated that in many cases the limited funds available for promotion have led managements to restrict their brand-building efforts to the trade. This may be sufficient in cases where the trade is influential in guiding merchandising decisions, as is true in the shoe store and department store fields. Generally, however, it is the influence of consumers which is desired in the program, and that requires a large promotional fund.

Other Facilitating Factors

When a manufacturer has large sales for a wide range of products under one general or "family" brand, then the brand may be promoted to consumers at small cost per unit. While family brands may not have the pointed and sharp mental associations that go with individualized brands, yet they may become important marks in guiding consumer selection, or at least in gaining consumer acceptance of merchandise. Thus, many large manufacturers have found that their well-known family brands are valuable in soliciting business for their fabricated parts or materials from finished goods manufacturers. Clearly the good will attached to the marks of General Electric and Westinghouse as consumer brands has been valuable in the sale of the motors and other fabricated parts made by those companies. The large extent to which appliance manufacturers identify the motors in their finished goods shows their appreciation of the fact that the brand reputation of these companies contributes to the salability of finished products.

Recognition of the possible value of a well-known family brand for the many steels produced by subsidiaries is reported to have led the United States Steel Company to undertake promotion of its family mark in consumer media. Since 1936 a very sizable consumer advertising campaign has been conducted, accompanied by promotional efforts to the trade and among finished goods manufacturers to induce them to identify U.S. Steel in finished goods. While such a program is costly in total dollars, it represents a small percentage of sales for a company of this size. As with Armco, while the differentiation offered may not appear highly significant to consumers, yet the well-known label may have some sales value. In the competitive steel market this may be just enough of a plus factor to enable U.S. Steel subsidiaries to approach finished goods manufacturers with better prospects of making continued sales.

Another situation where promotion to consumers is less costly is that of companies which have sizable markets for replacements of their fabricated materials or parts. Such companies have double reason to establish their brand reputation at the consumer level: (1) in order to get finished goods manufacturers to favor the brand for original fabrication; (2) in order to get consumer favor in replacement orders. In the early history of the automobile business many parts used in the assembly of cars were advertised for these two reasons—especially tires, batteries, and brake linings.

Summary

Opportunity to advertise and promote fabricated materials and parts to good advantage at the consumer level seems to turn on the presence of the factors enumerated above, namely, significant new product ideas, merchandise to meet a real consumer need, significant differentiation from other products, and sizable promotional funds. Not all these factors need be present; good opportunity may exist with a proper combination of them.

It may be well to close with another generalization illustrated by an observation of what has happened in the automobile industry. As the reputations of finished goods brands become firmly established, their manufacturers appear less inclined to rely and trade upon the reputations of fabricated materials or parts brands. In earlier years it was the custom of automobile manufacturers in their advertising and selling to list the well-known branded parts included in their products: body, engine, tires, batteries, brake linings, upholstery, horn, and so on. As the reputations of the automobiles grew, the managements evidently became desirous of being independent—of building and relying on their own brands. Less and less in their promotion have they cited fabricated materials and parts.

The moral is: It is a difficult job to establish brand reputation for fabricated parts and materials at the consumer level. It can be done; that is clear. But it can only be done when circumstances are favorable and care and foresight are exercised by management.

FUNCTIONS OF THE SALES EXECUTIVE

Functions of Sales Management

The size and character of the sales organization, the industry, the market, and the product all have an important influence on the functions of the sales executive. Besides these objective factors, the scope and nature of the work are affected by situations peculiar to the individual company—the influence of personalities, the special aptitudes and interests of the sales head and his subordinates, and the sales manager's own conception of what his job should be.

Sales management functions may be grouped generally as including those relating to (1) the sales program, (2) the product, (3) the market and the trade, (4) the sales organization, and (5) business development. The chart on the following page is designed to show the general scope and nature of the job of sales management. Although it does not list all the many detailed activities performed by the sales manager, the functions included are believed to be fairly representative. They have been grouped according to the major classifications referred to above, each of which is discussed briefly in the following sections.

The Sales Program

A basic responsibility of sales management is to lay out a sales program that will prove practicable and profitable to the company. This involves sales planning, with a scientific approach to the question "What shall we do?" and considers both long-term and immediate objectives. Planning is preliminary to the performance of all sales operations and serves to unite activities relating

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Source: A report of the Policyholders Service Bureau of the Metropolitan Life Insurance Company, New York City, 1946, pp. 12–55. Reprinted by permission.

SALES MANAGEMENT FUNCTIONS

I. THE SALES PROGRAM

- A. Plans
- B. Policies
- C. Methods

II. RELATING TO THE PRODUCT

- A. Product Development
  - 1. New Products
  - 2. Modifications
  - 3. Uses or Applications
  - 4. Style, Color, and Design
  - 5. Pretesting
  - 6. Length of Line
  - 7. Standardization
  - 8. Obsolete Items
  - 9. Packaging
- B. Pricing and Terms
  - 1. Price Structure
  - 2. Quotations
  - 3. Terms of Sale
  - 4. Discounts
  - 5. Allowances
  - 6. Credit and Collections
  - 7. Instalment Selling
- C. Physical Handling
  - 1. Transportation
  - 2. Warehousing
  - 3. Inventories

III. RELATING TO THE MARKET AND THE TRADE

- A. Market Research
  - 1. Present Markets
  - 2. New Markets
  - 3. Potentials
  - 4. Market Coverage
  - 5. Market Conditions and Trends
  - 6. Profitable and Unprofitable Markets
  - 7. Buying Habits and Preferences
  - 8. Market Acceptance of Product
- B. Customer Relations
  - 1. Good-will Building
  - 2. Service
  - 3. Claims and Adjustments
  - 4. Reciprocity
- C. Competition
  - 1. Industry Problems
  - 2. Competitors' Methods and Products
  - 3. Trade Association Activity
- D. Distribution
  - 1. Channels
  - 2. Outlets
  - 3. Number, Size, and Location of Distributors
  - 4. Relative Profitability
  - 5. Distributor Contracts and Agreements
  - 6. Distributor Morale
  - 7. Changes in Distribution Methods
  - 8. Marginal Territories

IV. RELATING TO THE ORGANIZATION

- A. Sales Personnel
  - 1. Selection
  - 2. Conditions of Employment
  - 3. Training
  - 4. Compensation
  - 5. Turnover
  - 6. Morale and Motivation
- B. Sales Direction
  - 1. Sales Territories
  - 2. Sales Presentation
  - 3. Routing
  - 4. Quotas
  - 5. Lines Handled by Salesmen
  - 6. Sales Correspondence
  - 7. Allocation of Accounts
  - 8. Sales Meetings and Conferences
  - 9. Sales Conventions
  - 10. Sales Manuals
  - 11. Exchange of Sales Experiences
  - 12. Sales Office Supervision
  - 13. Order Handling
  - 14. Field Reports
- C. Sales Control
  - 1. Budgets
  - 2. Forecasts
  - 3. Distribution Costs
  - 4. Selling Expenses
  - 5. Sales Performance
  - 6. Control Reports
  - 7. Sales Records and Statistics
- D. Coordination
  - 1. Within Sales Department
  - 2. With Other Departments
  - 3. With General Management
  - 4. Committee Duties
  - 5. Organization Setup
    - (a) Headquarters
    - (b) Field

V. RELATING TO BUSINESS DEVELOPMENT

- A. Advertising
  - 1. Appropriation and Budget
  - 2. Media
  - 3. Brand Establishment
  - 4. Campaigns
  - 5. Cooperative
  - 6. Publicity
  - 7. Promoting Use by Sales Organization
- B. Promotion
  - 1. Trade Shows and Exhibits
  - 2. Displays
  - 3. Sales Campaigns
  - 4. Contests
  - 5. Missionary Work
  - 6. Sales Kits and Samples
  - 7. Dealer Helps
  - 8. House Organs
  - 9. Bulletins
  - 10. Motion Pictures
  - 11. Sampling
  - 12. Premiums
  - 13. Testimonials
  - 14. Leads for Salesmen
  - 15. Inquiry Follow-up

to product, customer, sales personnel, and promotional efforts into a cohesive, workable program. With objectives determined, the sales manager outlines the policies or "rules" by which the sales program and the individual functions may be administered, and devises methods by which they may be put into effect.

THE PRODUCT

The effectiveness of the sales program depends largely on the product. Therefore, in conjunction with engineering, research, and production executives, the sales manager is concerned with the development of new products and the improvement and modification of existing products and services. He must see that packaging is economical and attractive. It is his specific function to bring the sales viewpoint to product problems and to appraise the product from the standpoint of its acceptability to the market. In addition, the sales manager collaborates with financial and accounting executives in determining pricing policies and price schedules, selling terms, discounts, and allowances, and he supervises quotations. Various duties are involved in the physical handling of the merchandise, including shipping, warehousing, and control of finished goods inventories. In all these the sales manager has an interest, although he may not be personally responsible for some of them.

THE MARKET AND THE TRADE

A third group of functions, which some executives believe have been neglected, has to do with factors external to the company. In this category there is the responsibility for study and interpretation of market demand. This includes research to locate and appraise new markets and to analyze product acceptance, buying habits, customer preferences and tastes, etc., so that the company's product and selling methods may be properly adapted to the requirements of the market. The sales manager is also charged with developing and maintaining sound customer relations, and good will. This involves various aspects of customer service, handling complaints and adjustments, and related activities. In companies selling through distributors there are many phases of distributor relations, such as the selection of distribution channels and outlets, dealer arrangements, and other activities involved in securing and maintaining adequate distribution. It is important also that the sales manager keep in touch with competitors' activities and with conditions in the industry. He observes competitors' methods, studies their products, and often enters into cooperative activities through the medium of trade associations or similar agencies.

THE ORGANIZATION

The numerous activities involved in building up the sales organization and directing, controlling, and coordinating the sales personnel comprise a fourth major group of sales management responsibilities. First there is the necessity of providing adequate manpower properly trained and motivated. Then there is the responsibility for directing actual selling operations. This may involve providing necessary selling tools, allocating territories and accounts, routing, rendering personal assistance, inspecting, and controlling salesmen in the field. To provide a basis of measurement and control, standards of performance are established in the form of sales budgets or quotas covering either sales volume or selling costs, or both. Administration of the sales budget may be in the hands of an accounting or budgeting executive, but the sales executive is responsible for sales performance and selling costs in the final analysis.

Another function of the sales executive in this group is the coordination of sales activities with other phases of the business. This is discussed in more detail in a later section of this report.

Business Development

Finally, sales management is responsible for advertising and promotional activities designed to maintain sales volume and create new business. These functions supplement and support personal selling efforts in the field. Various sales promotional devices employed include contests, exhibits, displays, sampling, salesmen's aids, etc. The supervision of these activities, and questions of advertising policy and allocation and control of advertising and promotion expenditures, are the direct concern of the sales executive. In this survey it was found that in 78 percent of the contributing companies the advertising manager is subordinate to the head of the sales department. Even in the other companies where the advertising department reports to the general management, the sales manager still retains definite advisory responsibilities with regard to the advertising function.

Functions of Different Types of Sales Executives

A clear understanding of the specific duties of the sales executive, and the manner in which they are allocated within the department, can be obtained best by discussing the functions of the different types or grades of sales executives separately. Sales executives can be grouped under six general classes: (1) the policy-making executive who determines but does not execute the sales program; he is the top sales executive, frequently with the title of vice-president in charge of sales; (2) the subordinate operating executive who directs the execution of the sales program; (3) the combination policy and operating executive, common to the smaller companies, who is responsible for both the determination and the execution of the sales program; (4) the territorial sales executive, commonly designated as divisional or regional sales manager, who is responsible for sales operations in a particular territory; (5) the product-operating sales executive, who directs sales operations on a particular product or line of products; (6) the product-staff executive or merchandise manager, who is responsible for the development and promotion of a particular product or line but who does not direct the actual selling operations.

The functions of each of these types of executives are discussed in the following pages. . . .

THE POLICY-MAKING EXECUTIVE

This type of executive is concerned largely with planning and coordinating activities, and delegates to subordinates the bulk of operating duties. Among the companies studied, two out of three of the sales executives of this type are members of the board of directors. Attendance at meetings of management committees and conferences with general management executives and the heads of other departments make large demands upon his time. At the same time he is required to maintain a general supervision over the sales department. Sales plans, policy questions, budgets, pricing, and expense control are other matters which require his personal attention.

An illustration of the functions performed by the planning type of executive is furnished by the director of sales of a hosiery manufacturing concern which sells direct to retailers on a nationwide basis through a large sales force. The director of sales, as head of the sales department, has reporting to him an assistant director of sales, five territorial sales managers, and various staff executives. His personal responsibilities are outlined as follows:

1. Plans and schedules sales operations.
2. Formulates sales policies and programs.
3. Interprets sales policies and programs to territorial sales managers at periodic conferences and to salesmen at general sales conventions.
4. Coordinates sales activities through contacts with the general management, manufacturing, and accounting departments; the advertising agency; and the sales executive staff.
5. Supervises sales activities, generally through territorial sales managers and occasionally, where necessary, to salesmen directly.
6. Acquires knowledge of sales results through daily sales reports from salesmen, periodic divisional reports, office reports, and information from sales executives.
7. Approves major expenses of sales department.
8. Determines special prices on merchandise.
9. Supervises styling and merchandising of product through reports from style counsel and merchandising managers and through field and office contacts with key accounts.
10. Contacts important accounts in the field and in the office.

In addition to his planning and coordinating functions, a significant aspect of this executive's job is the emphasis placed upon expense control, pricing, checking results, styling, and merchandising. Little personal attention is given to selection and training of salesmen or to the details of advertising and sales promotion, which are delegated to the territorial sales managers and the advertising manager respectively.

A somewhat different interpretation of the job of the policy executive is represented by the vice-president in charge of sales of an office machines manufacturing company which employs well over a thousand salesmen. In addition to the usual policy-forming, planning, and coordinating activities, this executive gives considerable attention to marketing research, sales training, advertising, and sales promotion. He personally directs the research for new markets and the expansion of existing markets. He visits sales training schools and training meetings in branch offices. Also, he originates and cooperates on advertising and sales promotional campaigns, often attending conferences on direct-mail campaigns, space advertisements, and advertising folders.

In contrast to the two previous cases, a company manufacturing heavy industrial equipment presents somewhat different conditions. This company sells its products direct to the industrial user through a small force of about a dozen salesmen. The sales head is a vice-president, who, in addition to his sales duties, is also responsible for service, engineering, and inspection. Because of the small size of the sales force, problems relating to the selection, training, control, and direction of the salesmen are relatively simple. Furthermore, with a limited number of potential customers, such functions as marketing research, advertising, and sales promotion are less important than in companies selling to mass markets. The major problem, from the standpoint of this sales vice-president, is the correlation of sales, servicing, engineering, and inspection, and the establishment of sound policies affecting these activities. In addition, he is concerned with the development and adaptation of the company's products, participates in trade association activities in his industry, sees to the maintenance of proper customer relations, and handles personally certain sales of an unusual nature.

THE SUBORDINATE OPERATING EXECUTIVE

The main responsibility of the operating executive is to direct the selling operations of the field force either personally or through branch, district, or regional managers. In this connection he usually spends a good part of his time in the field, working with the sales organization and making calls with them on prospects and customers. He is frequently charged with the administration of the home office sales department, including supervision of routine activities, systems, and procedures.

He participates importantly in personnel matters in the sales department and is usually responsible for the selection and training, compensation, and promotion of salesmen. Distributor relations occupy an important place in his program. He frequently is responsible for the preparation of sales budgets, sales quotas, sales analyses, and other control information. While the operating executive does not have final authority on sales policy matters, he is depended upon in a large measure by his superior for the facts and information needed in making policy decisions. Since he is closer to the field of operations than the chief sales executive, his value as an advisor on policy matters is apparent.

The job of the general sales manager of a company manufacturing heavy industrial machinery furnishes an example of the type of functions performed by the operating sales executive. This company employs 150 salesmen and sells its products through a number of branch offices. A vice-president in charge of sales heads the sales department and delegates the execution of the sales program to the general sales manager, whose specific duties are as follows:

1. Coordinates activities within the sales department.
2. Handles all matters pertaining to the administration of district offices and sales agencies.
3. Is responsible for all questions pertaining to the personnel of the sales organization.

4. Is in charge of leases for offices and warehouses.
5. Assigns territories.
6. Is responsible for office equipment in district offices and at headquarters.
7. Coordinates interoffice and interdepartmental functions.
8. Is responsible for statistics covering quotas, budgets, inventory, consigned stock, orders, cancellations, credit, etc.
9. Supervises the general sales department, including the stenographic, filing, and statistical sections.
10. Directs the advertising and sales promotional activities through an advertising manager.
11. Directs and supervises sales training.

It will be noted that this executive is concerned largely with "inside" home office activities, less attention being given to the actual direction of selling operations.

There is more direct participation in sales direction by the general sales manager of a company manufacturing metal alloys. This concern employs a dozen salesmen, who sell direct to metal processors. Under the general supervision of a vice-president in charge of sales, the general sales manager carries on many of the activities listed in the preceding case. In addition, he assists district managers and salesmen in selling, sells certain personal accounts, and makes goodwill calls on the trade. He is responsible for the export business and is expected to maintain close contacts with the plant and to submit recommendations on what to produce and stocks to carry. He also serves as a member of the advisory board, which coordinates and determines sales policies.

THE COMBINATION POLICY AND OPERATING EXECUTIVE

In many companies, particularly the smaller ones, both the determination of the sales program and its execution are the responsibility of the chief sales executive. In effect, he combines the duties of the policy-making and the subordinate operating executives previously discussed.

The functions performed by the vice-president in charge of sales of a small paper products manufacturing concern which employs less than a dozen salesmen, are illustrative of the duties of this type of executive. His responsibilities include the following:

1. Determines sales policies.
2. Serves as point of contact with other department heads.
3. Is responsible for the administration of the sales department and supervises its routine.
4. Coordinates sales and advertising efforts under his jurisdiction.
5. Supervises product development.
6. Establishes sales budgets and quotas.
7. Is responsible for sales cost control.
8. Participates in trade association activities.
9. Is responsible for price lists and trade agreements.
10. Contacts important customers and distributors.
11. Exercises general supervision over sales correspondence with customers.
12. Maintains customer control records.
13. Reviews salesmen's daily reports.
14. Reviews expense accounts.
15. Allocates sales territories.
16. Hires and trains salesmen.

To show how the responsibilities of this type of executive may be affected by the nature of the product and the size of the sales organization, the case of a cement manufacturing company may be cited. This company, with well over a hundred salesmen, has divided its sales territory into two divisions, each headed by a vice-president reporting to the president. Because of conditions peculiar to this industry, these executives are required to spend about a third of their time personally contacting and selling accounts. As a further contrast with the previous example, this company's sales executives devote little attention to the administration of home office routine and exercise less direct control over salesmen's activities and expenses.

THE TERRITORIAL SALES EXECUTIVE

The territorial or regional sales executive is responsible for all sales activities in a particular territory. However, he usually depends largely upon the home office for broad sales planning and such staff functions as advertising, promotion, research, etc. He supervises and directs the branch or district managers and the sales force in his territory from the standpoint of sales, service, and operating efficiency. He spends a large part of his time on the firing line with the salesmen checking their work, making calls with them on the trade, and handling certain major accounts personally. Sometimes he is responsible for the selection and training of the sales personnel in his territory.

In a company manufacturing hosiery, the territorial sales executives have the title of divisional sales manager. They report to the chief sales executive and each is responsible for the following functions:

1. Supervises and directs the activities of the salesmen in his division.
2. Contacts salesmen in the field.
3. Studies salesmen's reports.
4. Studies semiannual sales record sheets of the cities in his division (furnished by the home office).
5. Issues periodic bulletins, letters, and instructions to salesmen concerning the work to be done in the division.
6. Conducts salesmen's contests.
7. Conducts sales of special merchandise, etc.
8. Contacts important accounts with salesmen to develop closer association with the company and to clarify difficult distribution problems.
9. Gets dealers' reactions to company policies, new merchandising ideas, etc.
10. Interprets home office instructions to the sales force.
11. Supervises territory changes.
12. Seeks to improve operations of individual salesmen.
13. Confers periodically at the home office regarding company policies, line improvements, publicity campaigns, etc.

THE PRODUCT-OPERATING SALES EXECUTIVE

Companies selling a wide variety of products frequently follow the practice of breaking down the sales department into product divisions. At the head of each division is a sales executive who is responsible for the sale of one line of products. These product sales executives are of two types—operating and staff. The product-operating sales executive is in direct charge of selling operations and supervises the branch or district managers and salesmen under his control. Sales organizations that have product-operating sales divisions usually have a separate sales force for each division.

The functions of an operating sales executive in charge of a product line do not differ greatly from those of the general operating sales executive previously discussed, the difference being largely one of degree or scope of activities. In companies of equal size, a product-operating sales executive probably would get closer to the detailed aspects of the job than would be possible in the case of a general operating executive.

THE PRODUCT-STAFF SALES EXECUTIVE

The product-staff sales executive, or merchandise manager, differs from the product-operating sales executive in that he ordinarily has no direct control over the salesmen and, at least theoretically, his instructions to the field go through the chief sales executive or the chief's operating subordinate. A product-staff sales executive is charged with the development of his particular product line and the adaptation of the product to the market. He seeks to improve the salability of the product, to develop new products, to develop new uses, etc. He determines prices and prepares price and catalog data. He is responsible for developing sales promotional ideas for his line and for devising the best methods of distribution. Frequently he goes into the field to promote his line and to give the salesmen information about the product that will enable them to do a better selling job. He makes recommendations to his superior on sales policy matters affecting his line. There is very little standardization of functions for this type of executive. Sometimes the promotional functions predominate and in other cases the merchandising functions.

An illustration of the duties of the product-staff executive is furnished by a company that makes a wide variety of paper products sold to manufacturers, wholesalers, and retailers through a staff of about 175 salesmen. There are several product-staff executives who are known as merchandise line managers, and whose duties are:

1. Develops new merchandise, improves current merchandise, and finds new uses for the product.
2. Studies market trends to eliminate obsolete items and to discover what new items are worth while.
3. Estimates the amount of merchandise necessary to meet market requirements at different periods throughout the year.
4. Determines pricing policies and merchandise prices; makes changes in list prices of stock merchandise; prepares price estimates on special merchandise.
5. Promotes the particular line for which he is responsible.
6. Keeps in touch with trade and competitor relationships.
7. Maintains profit margins, as a joint responsibility with the production department.

HOW THE SALES MANAGER SPENDS HIS TIME

In considering the sales executive's job, it is interesting to know not only the variety of functions or activities included but also the relative importance of these functions in terms of time allocation. To provide a yardstick for comparative purposes, the contributors to this survey were asked to supply estimates of how they apportion their time, on an annual basis, among eight major sales activities, classified generally between operating functions and planning functions. Sixty chief sales executives complied. The results of this analysis are given in the table on page 549. In addition to showing the composite average amount of time devoted to each function for all 60 sales managers, the table also shows average time distributions for sales managers (*a*) of different types of products, (*b*) in different size companies, and (*c*) with the two types of organization setups, *i.e.*, with direct and indirect supervision of the field force by the chief sales executive. The analysis includes chief sales executives only.

As might be expected, the typical sales manager spends far more time on the many duties involved in sales direction than on any other function, the average being 28 percent. The other functions in the order of the average time devoted to them are: making calls with the field organization, 14 percent; sales planning and research, 13 percent; advertising and sales promotion, 10 percent; product merchandising, 9 percent; sales training, 8 percent; dealer relations, 8 percent; and selling personal accounts, 4 percent. Miscellaneous or unallocated activities accounted for 6 percent of the time of the average sales executive.

The time study reveals that the significance attached to the different functions varies with the type of product sold. Consumer goods sales managers are inclined to place more emphasis than industrial sales managers on such functions as market research, dealer relations, product development, advertising, and sales promotion. Conversely, the industrial sales executive attaches greater relative significance to sales direction and to making calls with salesmen. In general, he spends more time on operating functions and less on planning. Sales managers of commercial products who contributed to the survey spend far more time on planning than on operating functions.

The time devoted to certain activities is, of course, influenced by the size of the sales organization. For instance, in smaller companies there is a tendency for the sales manager to devote a larger share of his time to selling personal accounts and to the maintenance of satisfactory relations with distributors. On the other hand, the amount of time given to planning and research, advertising, sales promotion, and product merchandising increases directly with the size of the sales organization.

Naturally, the type of organization structure, the number of subordinates, and the manner of delegating functions affects the distribution of the sales head's time and effort. This is especially true in the case of sales direction. The chief sales executive who directs selling operations through subordinate executives devotes much less attention and time to this function (21 percent) than is true in cases where the branches or salesmen report direct to the sales head (36 percent). Furthermore, the sales manager who delegates the supervision of selling operations to subordinates spends just about twice as much time on sales training and product development, and almost twice as much on marketing research, advertising, and sales promotion as does the type of executive who directly supervises field operations.

How 60 Chief Sales Executives Apportion Their Time among Eight Major Sales Activities

Company Classifications	Number of Companies	Operating Functions (percent)					Planning Functions (percent)					Other (percent)
		Directing Sales Organization	Making Calls with Field Men	Trade Relations	Selling Personal Accounts	Total Operating	Sales Planning and Research	Advertising and Sales Promotion	Product Merchandising	Sales Training	Total Planning	
All companies	60	28	14	8	4	54	13	10	9	8	40	6
By type of product:												
Consumer goods	27	26	13	10	4	53	15	13	9	7	44	3
Industrial goods	28	31	16	7	6	60	9	7	7	8	31	9
Commercial goods *	5	26	3	6	1	36	23	15	16	7	61	3
By size of company:												
Large (100–10,000 salesmen)	18	28	13	7	4	52	15	11	10	7	43	5
Medium (26–86 salesmen)	22	29	14	8	5	56	13	12	9	7	41	3
Small (4–25 salesmen)	20	27	15	10	5	57	11	8	7	8	34	9
By type of organization:												
Direct supervision of the field force	24	36	13	9	4	62	10	9	6	5	30	8
Supervision through subordinates	24	21	13	9	4	47	17	11	11	10	49	4
Number of executives reporting each function	60	60	58	43	32	..	55	56	53	51		

* Includes products sold principally to offices and stores.

Coordination of Sales with Other Activities

Because of the fundamental importance attached to problems of interdepartmental relations, the chief sales executive is usually held personally responsible for the correlation of sales activities with other phases of the business. Frequently, it constitutes one of his most important functions. He is expected to see that the sales viewpoint is properly reflected in all phases of the company's operations, and conversely to make adequate allowance for the special interests of the other departments in the development of sales policies and the administration of the sales program. In other words, for the sales department, he must see that the broad company-wide interests rather than the narrower departmental interests are kept uppermost and that interdepartmental friction and misunderstanding are kept at a minimum.

Sales activities tie in with and affect practically every other division of the business. The volume of production, of course, depends largely on the efficiency of the sales organization and, conversely, continued sales are possible only when goods are produced in the qualities and quantities desired and at the time specified. Similarly, sales operations tie in with the financial and accounting divisions on matters of prices and terms, and the sales manager looks to the accounting department for the development of the records and data that are required for proper sales administration. On the credit and collection function, the sales manager is concerned with the development of a realistic credit policy that will not unduly throttle sales but will facilitate collections and reasonably restrict doubtful credit risks. The legal department is depended upon for the interpretation of laws affecting selling and for guidance in complying with governmental regulations. Sales operations affect traffic management on such matters as shipping, routing, freight rates, and the location of warehouse and storage facilities; the purchasing management on matters of reciprocity; and the engineering or research departments on product design and development.

Close cooperation between sales and production is highly essential. In some companies it is considered important not only that the sales executives have the production viewpoint, but that this be extended on down the line to the salesmen. This need is being recognized by having the salesmen spend a part of their initial training period in the factory, and by requiring them to return to the plant periodically to keep abreast of production problems.

At the present time one large manufacturing company is experimenting with a new plan of organization with the primary thought of securing closer coordination between sales and manufacturing. Under the old plan the sales department and the production department were both broken down by product divisions. Under the new scheme the corresponding product divisions in the sales and production departments have been combined with a general manager in charge of each product division, who controls both sales and manufacturing activities.

Most companies reported the use of formal management or policy committees for the purpose of coordinating the various activities of the business. These groups usually meet at regular intervals to discuss company-wide problems and are known by such names as the executive committee, operating committee, planning board, advisory board, etc. In all such cases reported, the chief sales executive was included as a member of the committee.

Formal committee meetings are usually supplemented by personal consultations and informal conferences among company executives and department heads. The one theme that ran through the comments of a great many contributors to this survey is the importance of developing close contacts among department heads and getting them together frequently to thrash out their problems face to face. It seems to be the general opinion that this is one of the best ways to break down barriers to effective cooperation.

Organization of the Sales Department

The basic factors influencing the organization of the sales department include the nature of the product and diversity of the line, variety of markets or types of customers, channels of distribution, size of the department, volume of sales, the personalities and abilities of the personnel, scope of distribution or area served, the practices of competitors, and conditions peculiar to the individual company. In this report sales organization structures are classified into five general types: (1) purely functional, (2) product, (3) market or customer, (4) territorial, and (5) combination product and territorial.

Functional Sales Departments

As the name implies, the functional type of sales organization is one in which the work of the sales department is broken down and allocated according to functions. For instance, one executive may be in charge of sales planning, another directing the selling operations, another in charge of advertising and promotion, another of market research, another of service, and so forth. In this purely functional type there is no division of responsibilities according to products or territories.

This plan of organization, of course, permits the personnel of the department to become adept in handling the functions assigned them, but may result in less specialized handling from the standpoint of particular products, territories, or customers. This disadvantage is emphasized in cases of wide or unrelated lines of products sold over a broad geographical market through a variety of distribution channels.

Roughly, 40 percent of the companies contributing to this survey have set up their sales department along purely functional lines. Most of these companies are small, 90 percent of them employing fewer than 40 salesmen and 50 percent of them employing even less than 20 salesmen. In most all cases these concerns sell a narrow or closely related line of products, or else their markets are very limited or concentrated geographically.

The purely functional type of organization does not appear to be peculiar to any particular industry or type of product. Both industrial and consumer goods manufacturers use it. For example, a representative sample of the contributors reporting the functional plan includes manufacturers of jewelry, food products, notions, pharmaceuticals, toilet goods, domestic appliances, wearing apparel, paper, leather, alloys, valves, machine tools, industrial machinery, motor trucks, and heavy industrial material handling equipment.

In four out of five cases of the purely functional organizations studied, it is the practice for the field force to report direct to the chief sales executive. In the remaining companies the branches or salesmen report through a subordinate operating executive. In the functional setup such staff departments as advertising, sales promotion, sales correspondence, market research, product development, sales engineering, service, and export sales are in most cases on the same horizontal level of authority reporting to the chief sales executive.

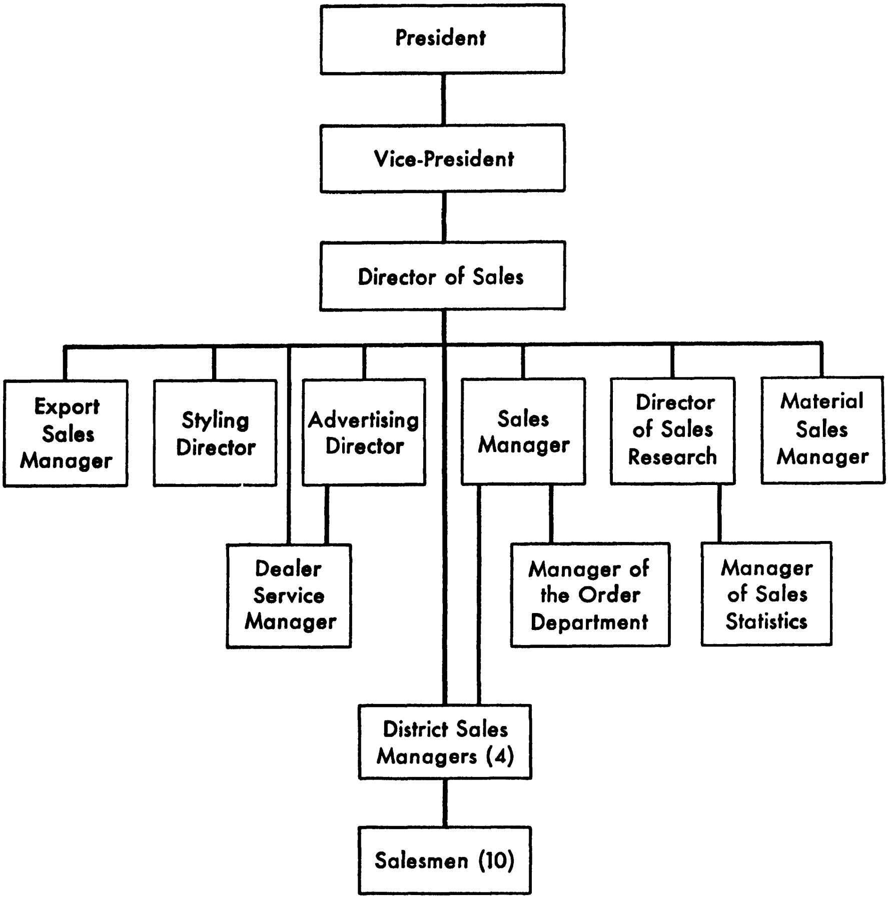

FIGURE 1. A watch manufacturer.

An illustration of the purely functional type of sales organization is shown in Fig. 1. This is the sales organization chart of a small manufacturer of watches sold through a selected group of wholesalers.

PRODUCT SPECIALIZATION

The second type of organization is one in which the work of the sales department is segregated primarily according to product lines. Twenty-eight percent of the contributors reported this type of organization. Where a separate sales executive is assigned the responsibility for the sale of one product or a group of related products, the usual advantages of specialization result. Not only is special attention given to the development and merchandising of the line, but special selling methods and techniques may be developed which are particularly adapted to that line. Furthermore, such specialization helps to keep the sales of different lines in better balance.

A possible objection to the product plan of organization is that it may require additional executive personnel, resulting in increased departmental overhead. It may also mean a separate sales force for each product division, with further increase in overhead, and the possibility of overlapping effort and duplication of calls on customers. If one sales force is maintained for all products operating under several product sales managers at headquarters, there is danger of confusion and conflicting authority on the part of the management and a divided loyalty and interest on the part of the salesmen.

The conditions under which product specialization is usually employed include: (1) unrelated or distinct product lines, (2) diversified markets or customer groups, (3) the need for distinct selling methods or techniques for the various lines, and (4) different distribution methods or channels for the separate lines. For example, a meat packer has separate sales divisions for fresh meat, canned meat, produce, and refinery products because of the distinctive nature of the merchandising and distribution methods required for each. A hosiery manufacturer makes a division between men's and women's hosiery because of variations in style problems and distribution channels. Still another manufacturer has separate sales managers for cosmetics and for toilet goods, such as tooth paste and disinfectants, because the company follows different sales policies on the two lines. A manufacturer of seating equipment has separate sales divisions for school, church, theater, and transportation markets; a steel manufacturer for fabricated and unfabricated products; a milling concern for packaged and bulk merchandise; a refrigerator manufacturer for domestic and commercial refrigerators; a typewriter manufacturer for standard and portable machines. Product divisions appear to be more common in industrial than in consumer goods sales organizations. Companies that sell both industrial and consumer goods almost invariably have separate sales divisions for these two groups.

Two methods of dividing sales responsibilities along product lines are employed. One is to split up the operating functions according to products, and the other is to break down the staff or planning functions along product lines. Under the former plan the product sales manager is strictly a line executive who directly supervises the branches or salesmen for the sale of his particular line. The staff type of product sales manager has no direct line authority over the field force. The line executive plan is commonly used where distinct product sales organizations are maintained, while the staff executive plan seems to be best adapted to companies where one sales force sells all products. One method seems to be used about as frequently as the other.

Product-Operating Specialization

In the majority of cases where the sales operating organization is set up on product lines, the product-operating sales executive reports to the chief sales executive of the company or to one of his immediate subordinates. In some instances there is no top coordinating sales executive over the product divisions, and the product sales executives report to an executive vice-president of the company or to the president. For example, in the case of a manufacturer of toilet articles and cosmetics, there are two sales managers, one for each line, who report direct to the president. As a rule, executives in charge of staff functions such as advertising, sales promotion, merchandising, market research, sales statistics, service, etc., are set up on the same level of authority as the product-operating sales executives, each reporting to the sales head. There are variations in practice, however, which will be pointed out later.

Sometimes the product divisions in a sales department are so distinct that they operate almost as separate companies. An illustration of this is furnished by a large floor coverings manufacturer with seven operating sales divisions within the sales department. Each has its own distinctive class of customers and uses different distribution methods. Each maintains its own district offices and sales forces. The sales divisions are headed by vice-presidents, and within the major divisions there are further product divisions headed by assistants to the vice-presidents. Some subordinates have charge of sales to particular markets or customers. Outside of the sales-operating divisions are advertising, traffic, research, legal, accounting, finance, production, purchasing, and engineering departments which serve all the divisions. However, each division handles its own marketing, sales promotion, product, and personnel problems.

More frequently, perhaps, the primary product segregation does not begin so high up in the sales organization, and there is a greater dependency by each product selling division upon a central authority for the determination of general sales policy, for the conduct of staff functions, and for general sales coordination. An illustration of this kind of organization is shown in Fig. 2. This concern sells a variety of fabricated and unfabricated plastic products. Thirty-one salesmen are employed, the majority of whom sell the products of their particular division exclusively. Only about three salesmen sell the products of more than one division.

While a strictly product setup may not be practical for the small company, it can achieve many of the advantages of product specialization by dividing responsibilities along product lines among the executives of the sales department who combine the promotion of a product line with other duties. An illustration is a small rubber products manufacturer employing six salesmen. The vice-president in charge of sales directly supervises the activities of four salesmen who sell the company's principal line. The secretary of the company, who also acts as an assistant to the vice-president in charge of sales, personally sells another line. Another sales department executive has charge of two salesmen, who sell still a third line to industrial users.

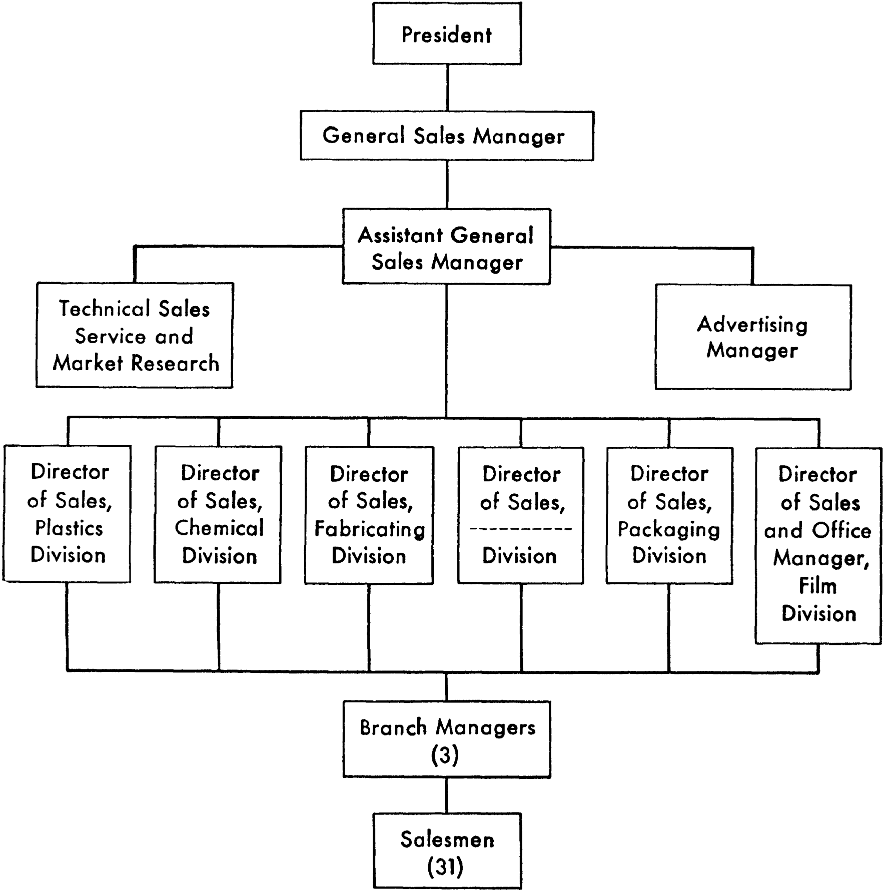
President
General Sales Manager
Assistant General Sales Manager
Technical Sales Service and Market Research
Advertising Manager
Director of Sales, Plastics Division
Director of Sales, Chemical Division
Director of Sales, Fabricating Division
Director of Sales, ---------- Division
Director of Sales, Packaging Division
Director of Sales and Office Manager, Film Division
Branch Managers (3)
Salesmen (31)

FIGURE 2. A plastics manufacturer.

Product-Staff Specialization

The product-staff executive is primarily concerned with product development and merchandising. Sometimes, however, these executives do participate in operating functions to a considerable extent, as some companies draw no hard and fast lines between operating and staff activities.

An illustration of a typical product-staff type of organization is shown in Fig. 3. This represents a concern with 142 salesmen and 37 district managers. The product sales managers in this company lean more heavily toward sales promotional duties than merchandising duties, and they spend a good part of their time in the field.

Several contributors reported having product-staff sales executives who are more or less cut off from the regular operating sales organization and whose interests are primarily product merchandising and pricing. Since these executives are outside the sales department proper they report to some member of the general management, either an executive vice-president or, more frequently, the president. In such cases the product executives are on an equal level of

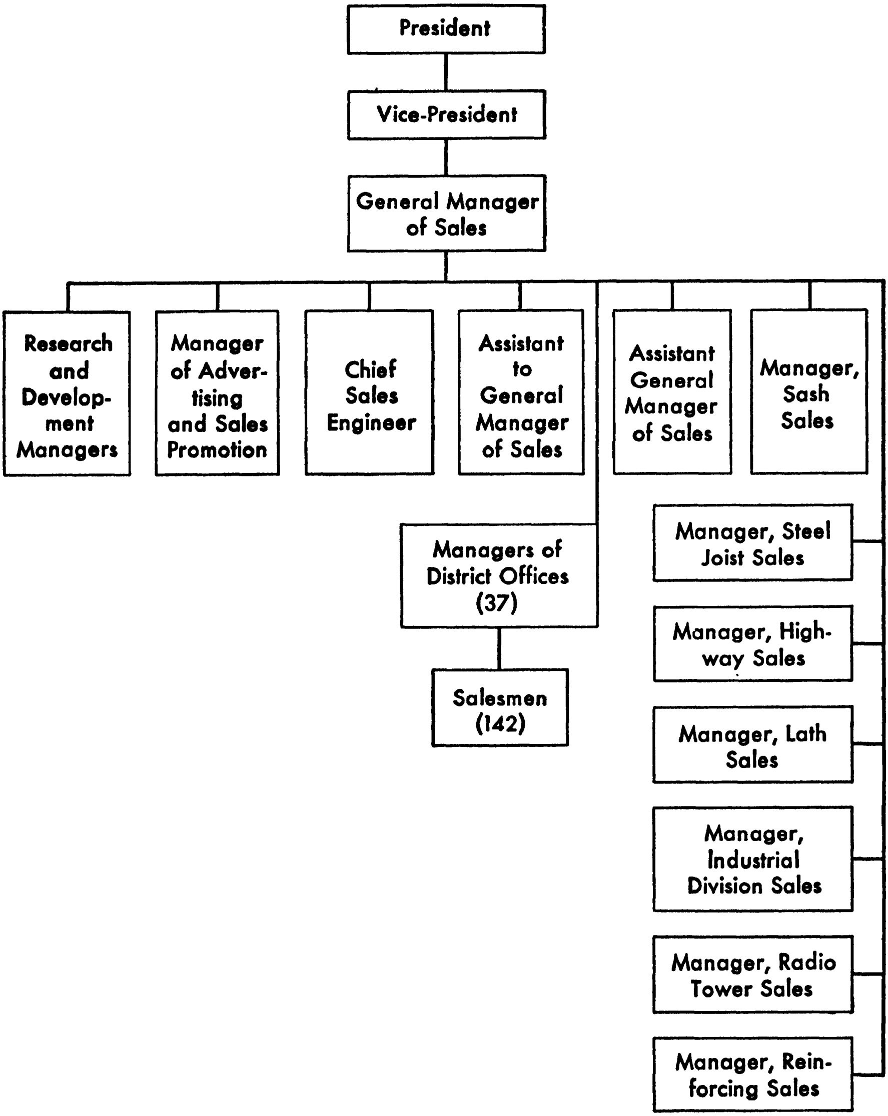
President
Vice-President
General Manager of Sales
Research and Development Managers
Manager of Advertising and Sales Promotion
Chief Sales Engineer
Assistant to General Manager of Sales
Assistant General Manager of Sales
Manager, Sash Sales
Managers of District Offices (37)
Salesmen (142)
Manager, Steel Joist Sales
Manager, Highway Sales
Manager, Lath Sales
Manager, Industrial Division Sales
Manager, Radio Tower Sales
Manager, Reinforcing Sales

FIGURE 3. A steel products manufacturer.

authority with the sales-operating head. Examples of such a setup include a textile products manufacturer, two meat packers, and a large manufacturer of industrial and farm machinery. Other companies that have separate merchandising and sales departments include a hosiery manufacturer, a large food products company, and a manufacturer of a wide variety of paper products. The sales organization chart of the last-named company is shown in Fig. 4.

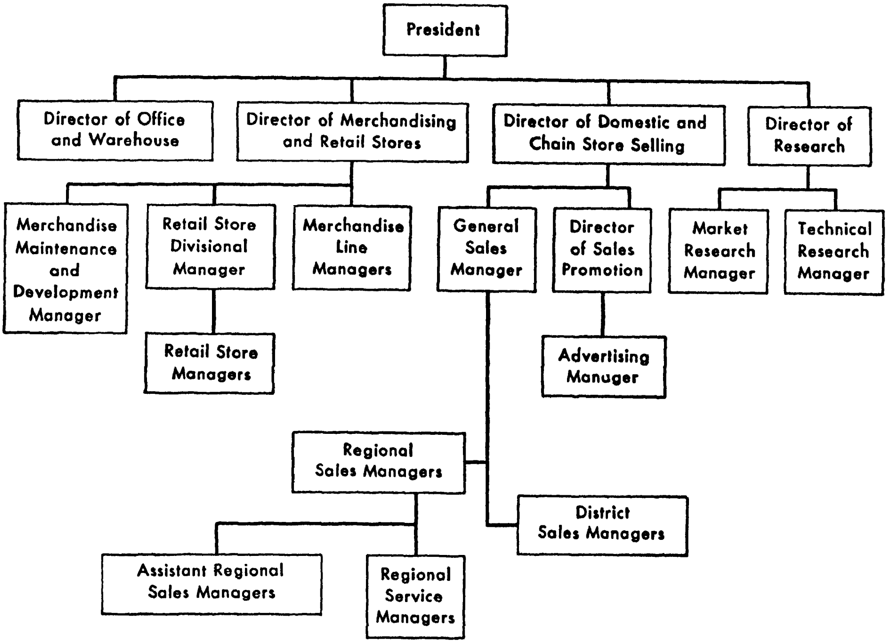
President
Director of Office and Warehouse
Director of Merchandising and Retail Stores
Director of Domestic and Chain Store Selling
Director of Research
Merchandise Maintenance and Development Manager
Retail Store Divisional Manager
Merchandise Line Managers
General Sales Manager
Director of Sales Promotion
Market Research Manager
Technical Research Manager
Retail Store Managers
Advertising Manager
Regional Sales Managers
District Sales Managers
Assistant Regional Sales Managers
Regional Service Managers

FIGURE 4. A paper products manufacturer.

Companies not large enough to have two or more divisions in the sales department for different products sometimes secure some degree of product-staff specialization by having one product sales manager in charge of one special line. For instance, one manufacturer of industrial equipment whose sales department is organized along territorial lines has a product sales executive for Diesel engines who serves in a staff capacity to the chief sales executive. A manufacturer of air-conditioning and related equipment also has a product executive with the title of air-conditioning sales manager, who specializes in problems affecting that line, performing such functions as the figuring of special air-conditioning jobs, assisting salesmen in selling air-conditioning equipment, and assisting in the preparation of price and catalog data for the line.

MARKET OR CUSTOMER SPECIALIZATION

Closely related to the type of sales organization with separate sales executives for different product lines, is the one in which the sales department is organized according to type of market or customer. Frequently, certain products or lines of products are sold exclusively to certain types of customers or markets, so that a segregation by product lines is equivalent to a segregation by type of trade sold. A variation of this plan, used by companies not large enough to set up separate divisions, is to make a single executive responsible for sales to a certain type of customer or some important market. For instance, a manufacturer of chemicals has an executive who specializes in sales to railroads and other transportation industries. A typewriter manufacturer with primarily a combination product-territorial setup has a special executive in charge of sales to schools. Likewise a hosiery concern has a college sales manager. Some concerns—such, for example, as a cleanser manufacturer—will have a specially designated executive in charge of sales to institutions. A cosmetics manufacturer's sales manager has two assistant sales managers, one in charge of sales to wholesalers and one in charge of sales to retailers.

TERRITORIAL SPECIALIZATION

Some companies break down their marketing areas and assign the responsibility for sales direction in each of these territories to a subordinate operating sales executive. With these intermediate levels of executive supervision, it has been found there is less danger of neglecting certain territories and a greater opportunity for more intensive sales direction and closer supervision of the sales force. Under this arrangement the territorial sales managers become specialists on the problems and peculiarities of their particular territories.

Thirty-two percent of the companies contributing to this survey reported that their sales departments are organized on a territorial basis. This type of setup is common to both consumer and industrial goods industries, although it was found more frequently in the consumer goods field, doubtless because of the larger sales forces employed in selling to mass markets. The purely territorial type of organization is usually found in companies with a comparatively limited variety of products. Companies in the consumer goods field that reported straight territorial setups include manufacturers of such products as hosiery, liquor, tobacco, food products, paper products, household polishes and cleansers, kitchen utensils, oil burners, and refrigerators. In the industrial field the plan is employed by concerns whose products are sold in fairly wide markets, such as office and store machines and equipment, building materials, weighing scales, fire extinguishers, industrial time recorders, clock and alarm systems, elevators, air-conditioning equipment, and industrial and farm machinery.

Naturally, territorial divisions in the sales department are more common in the large companies. Most of the contributors reporting territorial breakdowns employ more than a hundred salesmen. Due to the many variables involved, however, it is impossible to indicate the size of sales organization for which such a setup would be justified or the number of territorial sales executives required. The practices of individual companies may be of interest in this connection, however. The [accompanying] tabulation shows, for 10 representative companies, the number of territorial sales executives, the number of district or branch managers, and the number of salesmen. The fourth column gives the number of field men (branch or district managers and salesmen) per territorial sales executive. It will be noted that where the ratio of branches or districts to salesmen is low, there is usually a smaller number of salesmen per territorial sales executive.

RELATION BETWEEN THE NUMBER OF TERRITORIAL SALES MANAGERS AND THE SIZE OF THE FIELD ORGANIZATION

Product	Number of Territorial Sales Managers	Number of Branches or Districts	Number of Salesmen	Number of Field Men per Territorial Sales Manager
Office and store machines	7	210	1,300	216
Office equipment and supplies	3	39	450	163
Weighing scales	5	181	600	156
Polishes and cleansers (household)	2	20	200	110
Air-conditioning equipment	2	53	150	101
Cement	2	12	150	81
Liquor	3	21	200	77
Tobacco	8	2	500	63
Oil burners	4	None	60	15
Refrigerators	6	None	81	13

Territorial sales executives are most frequently designated as regional sales manager, divisional sales manager, territorial sales manager, or Eastern, Western, Southern, Central, etc., sales managers. Titles less often used include zone sales manager, sectional sales manager, and the plain designation of sales manager or assistant sales manager.

In two out of three companies with a territorial arrangement the territorial sales executives report direct to the chief sales executive. In most all other cases they report through a subordinate or assistant to the sales head. For instance, there are a number of concerns in which the territorial sales executives report to a general sales manager, who in turn reports to a vice-president in charge of sales. Almost always the territorial sales executives are strictly operating men and have no major staff functions under their jurisdiction. There are exceptions where the territorial segregation is made near the top of the sales organization. For instance, the sales department in a building material company with 150 salesmen has two sales vice-presidents, one in charge of the Eastern and the other the Western division. Each divisional vice-president has his own staff departments, such as advertising, traffic, service, etc.

Illustrations of two types of territorial sales organizations are shown in Figs. 5 and 6. The first is the more common type, with the territorial sales executives as purely operating men. The company represented by this chart is a manufacturer of paper products employing 186 salesmen. It will be noted that in this case there is more than one intermediate level of territorial sales executives. Figure 6 is the chart of the building material manufacturer mentioned in the previous paragraph.

There are many variations in the use of the territorial arrangement. For example, a food products manufacturer has five territorial sales executives, and under each of these are two product-staff men, each serving the territorial sales executive in a staff capacity on a particular product line. Another concern has service managers reporting to the territorial sales executives, while executives in charge of all other staff functions such as merchandising, advertising, sales promotion, research, etc., are responsible to senior sales executives.

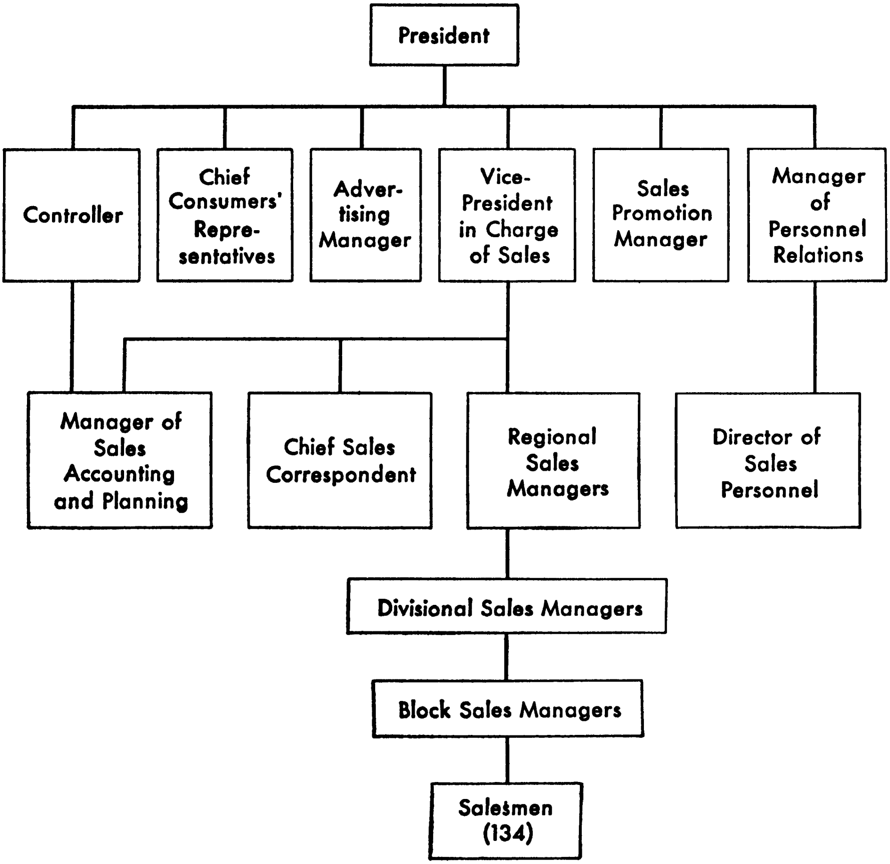
President
Controller
Chief Consumers' Representatives
Advertising Manager
Vice-President in Charge of Sales
Sales Promotion Manager
Manager of Personnel Relations
Manager of Sales Accounting and Planning
Chief Sales Correspondent
Regional Sales Managers
Director of Sales Personnel
Divisional Sales Managers
Block Sales Managers
Salesmen (134)

FIGURE 5. A paper products manufacturer.

Although a territorial breakdown of the sales organization is employed primarily by the larger companies, some smaller companies have taken some action in this direction. For instance, a small manufacturer of kitchen utensils, with 23 salesmen, has an Eastern sales manager and a Western sales manager, both reporting to a general sales manager. A manufacturer of domestic oils, with 38 salesmen, has an Eastern sales manager, to whom district sales managers in the East report. District managers in other sections of the country report direct to the general sales manager.

Several of the small companies contributing to this survey employ field sales supervisors for better territorial sales supervision. A toilet goods manufacturer, with 32 salesmen, employs 2 such supervisors, who report to the chief sales executive. A manufacturer of cleansers, with 24 salesmen, also employs 2 territorial sales supervisors. Many of the large companies employ sales supervisors in addition to the territorial sales managers. Some large companies are also securing a greater degree of sales supervision along territorial lines through the use of main branches and sub-branches, the latter reporting to the former.

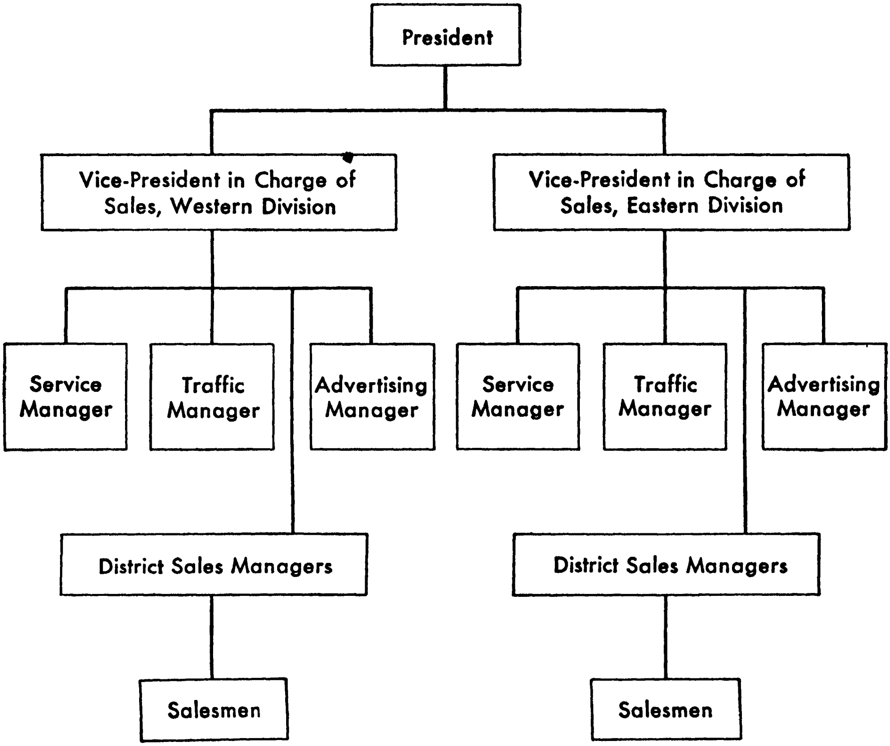

FIGURE 6. A cement manufacturer.

COMBINATION PRODUCT AND TERRITORIAL SPECIALIZATION

Some concerns that cover a broad market with a wide variety of products have both product and territorial sales executives with the idea of obtaining the advantages of both types of specialization. Fourteen companies reported combination setups of this kind. These include manufacturers of such varied products as hosiery, food products, refinery products, office machines and equipment, domestic appliances, and farm and industrial machinery.

Where the sales department is divided into both product and territorial divisions it is the usual practice (11 out of 14 companies) to have the product executives function primarily as staff men with no direct authority over the field force, the territorial managers performing this function.

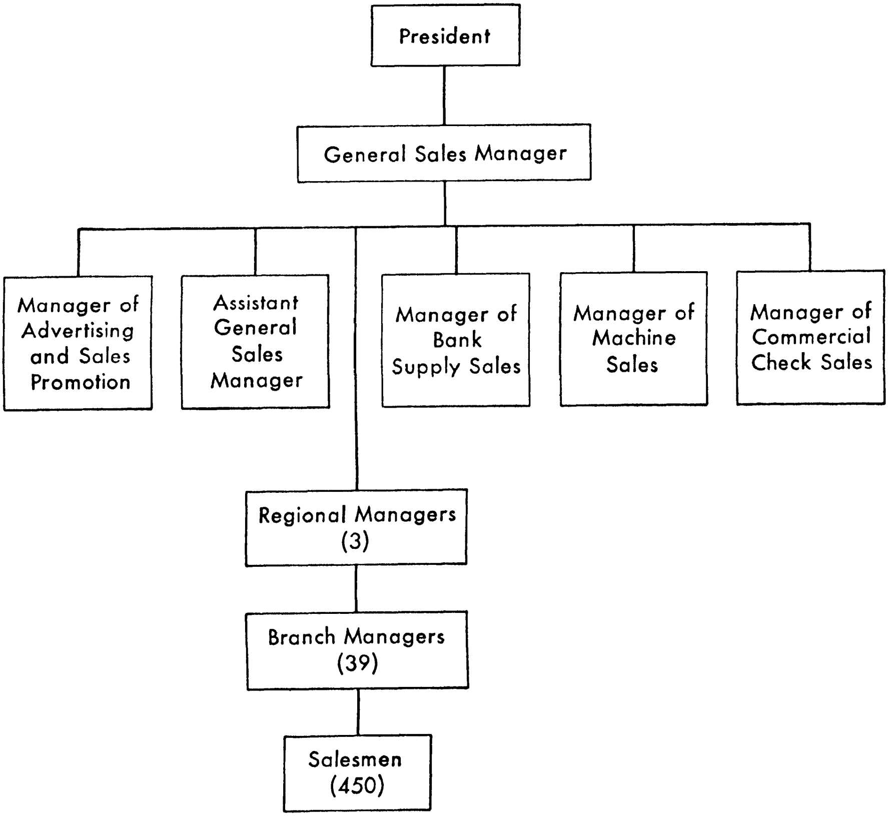
President
General Sales Manager
Manager of Advertising and Sales Promotion
Assistant General Sales Manager
Manager of Bank Supply Sales
Manager of Machine Sales
Manager of Commercial Check Sales
Regional Managers (3)
Branch Managers (39)
Salesmen (450)

FIGURE 7. A bank and office equipment and supplies manufacturer.

In such cases the product and territorial sales executives are usually on equal levels, reporting independently to the chief sales executive, as illustrated by the organization of an office machines company, shown in Fig. 7. In other cases the staff executives report to the chief sales executive, while the territorial executives report to a subordinate executive who in turn reports to the sales head.

When a company has both product and territorial sales executives and the former are operating men rather than staff men (this setup was reported by three companies), the problem of organization is more difficult because of the danger of conflicting authority as regards supervision of the field force. Two companies have worked this out by having the territorial executives report to the product executives, the former being in direct charge of the field organization. For instance, one company has two product divisions, each headed by an executive who reports to the president. Under one of these division heads there are two territorial sales managers, each in charge of a particular geographical segment of the market for his line. One of these territories is further subdivided under two regional sales managers.

The organization of a typewriter manufacturer, shown as Fig. 8, provides another illustration of a sales setup combining product-operating and territorial-operating features. Here the vice-president in charge of sales through two territorial subordinates directs the sale of the company's principal line of standard typewriters. Portable sales are in charge of a separate executive with his own staff of salesmen, who sell direct to dealers. (Sales of portables to others than dealers are handled by the regular sales organization.) There is also an executive in charge of sales of supplies who has his own supply salesmen working out of the regular branch offices. The portable sales manager and the supplies sales manager have definite operating functions, including selection and supervision of salesmen. In addition, they are responsible for product and pricing problems in their field. It will be noted that the company has a general service manager, who is entirely independent of the sales department, reporting to the president. This segregation of the service function was observed in a number of companies, particularly in the office equipment field. One of the principal

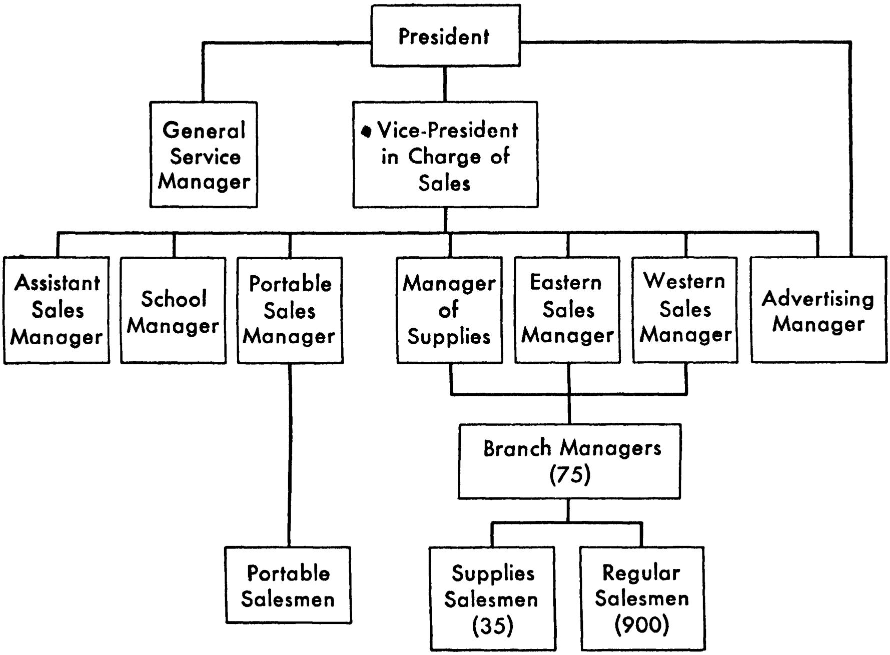

FIGURE 8. A typewriter manufacturer.

reported reasons for the separation is the desire to place a curb on excessive servicing costs. Several companies found that the sales department was inclined to be too liberal in granting free services, and made the service department directly responsible to the general management as a means of remedying this.

SELECTING THE ORGANIZATION PLAN

The fundamental purpose of an organization plan, whether it be for selling or any other function of business, is to provide a working arrangement that will facilitate operations, minimize duplication and overlapping of jurisdictions, and promote general efficiency of the individuals involved. No matter how correct it may be theoretically, if the plan of organization does not meet this practical test a change is indicated.

As stated previously, the size and nature of the business, the product, the type and location of the customers served, and, perhaps, most importantly, the personal element all affect the organization plan. The examples of actual sales organizations described in the preceding sections of this report illustrate the practical variations found in effect. These indicate that there is no standard arrangement that can be considered typical or correct for the sales function. Each company must analyze its own problem and work out the form of organization that best meets its conditions. Experiences and practices of other successful companies should be helpful in making this selection.

LOW-PRESSURE SELLING

BY EDWARD C. BURSK

Sales managers and salesmen in many lines decry "high-pressure" selling as a crude relic of bygone days. More and more they are advocating what can only be described as "low-pressure" selling. Although the swing from high-pressure to low-pressure techniques was gathering momentum long before the war, the scarcities of the last few years have accelerated it. Now, at the end of the war and just before goods become plentiful again, it is imperative that we examine this shift in the thinking of those who have to do with selling, which has gone so far that viewed in retrospect it looks like a complete about-face.

What actually is low-pressure selling? Is it the absence of high pressure, whatever that may be, or merely high pressure in clever disguise? Why is it effective—because it is different and takes people by surprise (which means it may lose its power as time goes on and buyers become hardened to it), or because it taps basic human reactions? Is low-pressure selling sound and productive—enough so to keep moving the increased volume of goods that our

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postwar planning calls for? Or are sales managers and salesmen relying on spineless techniques that will fall flat in a real buyer's market?

It is the purpose of this article to try to answer these questions, and then to consider the implications for sales management. Attention will be confined to personal selling; that is, selling by salesmen, and specifically outside salesmen rather than retail salesmen in stores. It should not be forgotten, however, that there are obvious parallels in other types of promotional activity, and of course, a company's personal selling strategy needs to be coordinated with its advertising program.

Furthermore, without wishing to anticipate the conclusions of this analysis, the author does want to acknowledge that he is chiefly concerned with selling to business buyers, both buyers for resale and industrial purchasers. These businessmen make buying decisions primarily on a rational rather than an emotional basis, and for this reason seem especially suited to low-pressure selling. There is no need, however, to rule out consumers. They too are now tending toward rational buying: witness the growth of such organizations as Consumers' Research as well as the inauguration of high school instruction in buying as part of domestic science courses and the more realistic attitude of the younger generation in general. Even the brush salesman, who used to be considered the prime example of high-pressure selling, no longer finds it desirable to try to wedge his foot in the door; instead he draws back as the door is opened, smiles courteously at the housewife, hands her a sample brush (or booklet during wartime), and says he will call for the order tomorrow.

As a matter of fact, the over-all trend toward more rational buying—hard-headed, discriminating, sophisticated—certainly has some connection with the trend toward low-pressure selling. Sales managers and salesmen have been alert to the change in buying attitudes, have capitalized on it in their selling techniques, and thus in turn have strongly re-enforced it.

WHAT IS LOW-PRESSURE SELLING?

Perhaps the easiest approach to deciding what low-pressure selling means is first to try to point out what it is not; that is, to define its opposite. Here we have as many definitions to choose from as there are people. Almost everyone who has ever bought anything nods his head when you say "high-pressure selling"; he has a feeling about it. Yet if all those feelings could be translated accurately into words, we might find them surprisingly uniform. Indeed, the factor that makes one kind of selling high-pressure and the other low-pressure may very well be the spirit in which the selling is done rather than anything more definite and concrete.

Some people will tell you, if you press them for a definition, that high-pressure selling means persuading the prospect to buy something which he cannot afford, which is not suited to his needs, which he does not want, and which will leave him dissatisfied after the salesman leaves. But that description, however characteristic, seems to denote the possible results of high-pressure selling rather than its fundamental meaning and purpose. Others call it "bludgeoning the prospect," "sweeping him off his feet," "not giving him time to catch his breath," "bewildering him," even "deceiving him." These phrases, although again they may be justified by the actions of many practitioners of high-pressure selling, seem more to suggest the manner in which such selling is sometimes performed than its fundamental nature.

Perhaps another phrase, "talking the prospect into buying," with the emphasis on "into," comes nearer to expressing what we want. For it simply implies that the prospect—or, by this time, the victim—has not reached the decision to buy through any rational, considered course of his own, but has been driven into it. This basic concept, that high-pressure selling means driving the prospect into a buying decision, fits in with and explains the other manifestations which we mentioned. Naturally such selling can have the effect of leading a person to buy something not wanted (although it does not need to); and naturally it lends itself to what may be called "strong-arm" methods (although the element of trickery and deceit may be grafted on any kind of selling, including low-pressure selling).

With this concept of high-pressure selling in mind, we can now go on to define low-pressure selling. We want to beware of oversimplification. In actual practice, of course, low-pressure techniques overlap high-pressure techniques or show up in combination with them; what we usually see is merely a difference in the degree of selling pressure. For the purpose of analysis and clearer understanding, however, we need to think of low-pressure selling as something essentially separate and distinct, the veritable opposite of high-pressure selling; and this approach to it will be justified subsequently if our discussion indicates that it does have a meaning and purpose of its own.

Letting the Prospect Decide for Himself

Low-pressure selling, then, is not driving the prospect into a buying decision, but letting him reach the decision himself; not selling him, but letting him buy. Put this way, it sounds simple. But a closer examination immediately raises some serious questions which, unless they can be answered satisfactorily, cast doubt on the long-run desirability of low-pressure techniques.

The very fact that we defined low-pressure selling by saying that it was not high-pressure selling suggests that it is nothing more than a weakening of the degree of selling effort. Indeed, such a suspicion is not without a realistic basis, for there is actual danger that sales managers and salesmen, in turning from previous selling techniques, will not try to replace their obvious all-out effort—which enjoyed a substantial degree of effectiveness if only by reason of its aggressiveness—with positive methods of equal or greater effectiveness in the new area of low-pressure selling.

When we say that low-pressure selling means letting the prospect decide for himself, can we possibly mean that there is no attempt at all to influence him? If so, then the buying decision rests entirely on an examination of the relative merits of competing products (or of competing claims on the prospect's money, time, warehouse space, and so on). And if the advantages of the salesman's proposition are presented fairly, that is, accurately, then only the superior product will be bought. But this kind of selling, unless supplemented by positive action of some kind, would not be selling at all. It would be a sort of information service, which would be better handled by an impersonal and objective research organization. From the point of view of individual companies it would be ineffective except in those rare cases of products with clearly demonstrable superiority. Clearly low-pressure selling has more positive character than that.

In the first place—and this touches directly on a fact which selling trainees find hard to appreciate—no matter how similar competing products may be in price and over-all quality, each usually has at least one minor feature, either in the product itself or in the service and terms associated with the product, which is unique and which makes that product more desirable for certain purchasers than the other products. Consequently, the salesman can high-light his own product's particular advantage, still leaving it to the prospect to decide rationally among the advantages of competing products.

In the second place, some kinds of positive action can be employed. Let us continue to assume that the buyer is free to arrive at his decision principally through his own rational thought. Yet even without dramatic devices, fast talking, or any other features associated with the high-pressure approach, there will still be differences in the degree to which the salesman's presentation elicits attention and arouses interest, that is, differences in the effectiveness of selling techniques. Moreover, emotional appeals need not be eliminated entirely, although they must of course be introduced more subtly. In this connection, it may be pointed out that even in the case of large industrial buyers, presumed to be making decisions on a completely rational dollars-and-cents basis, the appeal to vanity can often be employed without spoiling the effect of the low-pressure approach, and very tellingly. Consider, for example, the opportunity to stir up a feeling of pride in plant appearance when the attempt is being made to sell the president of a company a major item of equipment.

But how far can salesmen go in introducing appeals and other stratagems designed to put backbone in their low-pressure techniques and still be true to the idea of letting the prospect reach the buying decision himself?

NEED OF SINCERITY

There is the possibility, of course, that low-pressure selling can be used with the intention not so much of actually letting the prospect decide for himself as of making him think the decision is his own; in other words, trying just as hard to induce him to buy but disguising the attempt. Certainly there is more than a shadow of truth in such a concept. It hardly seems realistic to suppose that the salesman should be any less eager to sell; let us hope that he is not, or the selling is likely to be completely ineffective. Why should not the salesman at least do his utmost to set a favorable environment for the prospect's decision? Here is plenty of opportunity for selling ability.

At the same time, we ought to doubt whether real low-pressure selling can be based on the out-and-out cynical concept that the salesman is tricking the prospect into buying by pretending that he is not trying to sell at all. This of course raises the question of ethics, which is a very vital question, worth much more thought than it usually receives from sales managers and salesmen. The ordinary way to meet it is to observe that a certain amount of, shall we say, "exaggeration" and "selection of facts" seems to be expected of salesmen, and any buyer who fails to take salesmen's statements and maneuvers with a few grains of salt is considered "fair game." But that is not enough of an answer.

Surely, the spirit which motivates a salesman is significant. Most enlightened sales managers and salesmen, not to mention buyers, would agree that there is a line, real but impossible to draw precisely, between legitimate and illegitimate use (or abuse) of exaggeration, half-truth, and other types of misstatement. On one side is the salesman's normal, expected display of enthusiasm for what he is selling, and on the other side is intention to deceive and mislead. Most enlightened sales managers and salesmen would also agree that the latter should be avoided, not only because it is bad ethics but also because it is bad business. In most lines of selling, and certainly in all lines of selling where reputation and prestige have any continuing value, the feeling is that such action sooner or later comes to light and loses more sales than it ever gained.

As a matter of fact, this disapproval of flagrant deceit—call it good ethics, call it good business, or call it a combination of the two—is an integral part of a definite evolution in the dignity of selling, from the wily peddlers of the past to modern "sales representatives" and "sales engineers." Moreover, it may well be that the trend toward low-pressure selling, considered in its "purest" form, is not so much the revolution that it seems to be as a part of the same long-run development.

In any event, it is clearly possible that low-pressure techniques will defeat their own purposes unless animated by a substantial degree of sincerity. Sooner or later, if buyers get "burned" by lowering their resistance in response to a pretense of fairness and candor, they will begin again to mistrust all sales presentations, and the field will be open to the "slam-bang" methods of yesterday. Furthermore, and entirely apart from the danger of reprisals in the future, there is serious doubt whether the technique can ever be made fully effective unless it actually is carried through with sincerity. There are several reasons for this: (1) It is never easy to keep deceit and insincerity from showing in one's talk and action; it is doubly hard when one is supposed to proceed calmly and deliberately rather than in high-geared fashion. (2) Sincerity is the very crux of low-pressure selling, since the effectiveness of the technique hinges largely on the salesman's appearance of concern for the prospect. If a salesman is to convince a prospect by means of an attitude, then the attitude must be given a convincing demonstration, and that can hardly be done unless the attitude is genuine.

With this understanding, then, do we still have any right to say that trying to set a favorable environment for the prospect's decision is compatible with being sincere about letting the prospect decide for himself? But why not? Concern for the prospect provides one of the most effective ways to achieve the desired environment. Developed to its fullest form, such concern becomes what is sometimes called "the customer-problem approach"; and this approach, in turn, is the clearest crystallization of low-pressure selling. Let us look at a specific example of this approach and see how it works:

The Customer-Problem Approach

A company selling hosiery and underwear for men, women, and children, principally to department stores, found the customer-problem approach to be very hard to inculcate in salesmen, but very effective when the salesmen gave it a serious try. Although the company's products were of good quality and reasonable price, for each item there was no demonstrable edge over the same items in competitors' lines. However, the company did have a unique feature to talk about: the fact that, because of the unusually diverse line, quite a few different departments of a store could carry the company's brand, which was backed by substantial national advertising.

The executives of the company realized that department stores faced a real problem in their choice between nationally advertised brands and private, or individual, store brands. The former offered the advantage of low customer resistance and quick turnover. The latter, on the other hand, made it possible for a store to realize on the reputation of a brand built up in one department by featuring it in some other department. For instance, a woman who had become convinced of the reliable quality of XYZ hosiery for herself would also be disposed to buy XYZ socks or underwear for her children when she came across them in those departments. The company's unusually diverse line seemed to offer the advantages of both horns of this dilemma, with few or none of the corresponding disadvantages.

In soliciting stores which had not previously been customers, the company's salesmen, like most salesmen, usually came up against the objection that the store already carried more brands of hosiery and underwear than it really should from the standpoint of inventory costs; and, since they all were good brands, well-recognized by consumers, it would only cut profits to add another brand. Such an objection is hard to dispose of, for it has a sound basis, and the salesmen were accustomed to try to dodge it or, when they could not do so, to try to overcome it by talking about the "superior" quality of their brand of products. At the same time, although the salesmen were very successful in holding old customers and increasing the sales volume of accounts already on the books, they were failing to add new customers as fast as the sales manager thought they should.

He therefore urged them to follow this approach: (1) to meet without flinching, or even to introduce deliberately, the question of number of brands being carried by the store, and to encourage the buyer to talk about his problems in keeping inventory down; then (2) to say in effect that the brands already carried were of course good brands (thus flattering the buyer's judgment), just as good indeed as the brand that the salesman was offering; and finally (3) to point out that, even so, the salesman's brand might help to solve the store's problem because it combined the advantages of national advertising and store-wide reputation and thus would make it possible for the store to realize more sales, with a lower inventory cost per dollar of sales.

The plan worked. Note some of its points: There are no exaggerated claims about the product's superiority; as a matter of fact, the salesman compliments his competitors' brands. The salesman capitalizes on the one feature which makes his line different from his competitors' lines. There is a subtle appeal to the vanity of the prospect—slight, to be sure, but all the more effective because it is not obvious. The buyer is "opened up" by a question about his problems, a subject dear to his heart and sure to interest him; if it starts him talking, so much the better, for he is likely to give the salesman some good leads for further sales points later in the presentation. And, most important, by offering in effect to help him solve his problems, the salesman has made the buyer feel that he is making his own decision, and making it rationally.

This example should be enough to give a preliminary idea of the way in which sincerity and purposeful effort can be combined in low-pressure selling. Variations will be brought in as illustrations as we go on to discuss the reasons for the apparent effectiveness of low-pressure selling.

Reasons for Effectiveness

It should be emphasized, to begin with, that low-pressure selling is not likely to be effective in equal degree in all kinds of selling and that it naturally needs to be modified to suit particular circumstances. Nevertheless there appear to be certain basic reasons for its effectiveness.

The Element of the Unexpected

There seems little doubt that, at least in the earlier stages of their use, low-pressure techniques have been strengthened by the fact that prospects, expecting to be argued into buying, are taken aback and thrown off guard when exposed to a disingenuous approach. Take, for example, the story about the hard-headed businessman who was "poison" to experienced insurance salesmen, yet was "bowled over" completely by the fresh-faced lad who, admitting that he knew absolutely nothing about insurance, said such lack of knowledge didn't matter since the businessman in question was obviously the best judge of what size and kind of policy he ought to have. Of course it turned out to be a very large and expensive one.

There are obvious limitations to the usefulness of this factor. It hardly needs to be pointed out that if every insurance salesman intentionally tried the naive tactics referred to in the story, none of them would succeed. That fact again raises the question whether low-pressure techniques will continue to be effective as they become more and more common. Part of the answer lies in the observation that even now the prospect's surprise is not usually conscious or very extreme, and that in any event it must be supplemented by the salesman's use of positive action. An even larger part of the answer lies in the soundness of the psychological aspect of low-pressure techniques, which will be discussed in the next section; in other words, there is a sounder basis for effectiveness than that provided by the contrast with an obvious all-out effort to sell. The brush salesman with his new techniques may count on surprise the first time he calls; yet on subsequent calls he continues to operate with increased effectiveness.

At the same time, the element of the unexpected is not to be disregarded entirely. There are many fields where high-pressure techniques continue to be prevalent, and here the contrast provided by low-pressure techniques undoubtedly adds some degree of strength to the selling attempt. This is particularly true of what may be called the "delayed-action approach" and the "indirect approach," both of which lend themselves to low-pressure selling.

EXAMPLE: DELAYED-ACTION APPROACH

The essence of the delayed-action approach is that the obvious effort to secure a formal order is postponed beyond the normally expected time. Clearly this approach must be used with great care, lest salesmen, too much inclined as it is to avoid coming to grips and closing a sale, are further encouraged to shirk such action out of laziness or timidity. The point must be put across that despite the lengthening of time that salesmen may spend on individual prospects, the purpose of the approach is to increase the number of actual sales for the same expenditure of time and effort, and this does demand decisive action in closing sales at the proper moment. Clearly, too, this approach cannot be used in all types of selling, particularly "one-shot" selling, where the sale must be made on the first call or not at all. Rather, it is best suited for building up a route of customers who will be called on regularly.

Perhaps an example will clarify the strategy of this approach—an example to which the author can testify personally, for it resulted from an experiment he made in opening a new territory for the wholesale grocery business that he at one time owned and operated. A group of approximately 30 retail stores were called on. Fifteen of them (every other one) were approached by the usual techniques, and orders were solicited from the very start. Five stores were sold on the first call, but several of these failed to repeat the second time, and ultimately only four of the fifteen became regular customers. With the other fifteen stores, however, absolutely no attempt was made to sell the first time; the call consisted only of a pleasant introductory explanation of why the company was expanding its territory, what it had to offer (specialized service rather than better price or better quality), and the remark that the salesman would call again next week. This call was followed up by a letter from the home office, thanking the storekeeper for his courtesy to the salesman and including two or three short sentences about company policy. Then the next week the salesman called again, this time asking for orders. Ten of the fifteen stores placed orders, with all ten becoming regular customers.

This delayed-action approach was subsequently used to open other territories, with comparable results. Clearly, it was more productive to postpone trying to get orders beyond the first call, which was the normally expected time. Why? The element of the unexpected undoubtedly played some part: it surprised the prospects and had the effect of making them lower their guard. Also, something was gained by avoiding initial turndowns, for it is often harder to reverse turndowns than it is to get original orders. But probably most important was the simple fact that the approach avoided rousing unnecessary resistance in the prospects, and thus gave free play to the psychological factors discussed immediately below. The same comments could be made about the indirect approach, which will be illustrated subsequently.

People Like to Buy

This is the fundamental psychological reason for the effectiveness of low-pressure techniques. Assuming for the moment that none of the customary deterrents to buying are present, we can say that the act of buying gives the normal person a sense of pleasure. There is a certain feeling of power in being able to acquire things, entirely apart from any anticipation of enjoying the products or services bought. Buying flatters the ego. Certainly vanity is involved, particularly when a person thinks he is buying wisely and shrewdly, "getting a bargain." Incidentally, in this connection it is worth noting that in organizational shifts of function within business firms one of the powers least readily surrendered is the right to buy. There is also the happy fact that, unless impelled to the contrary, people like to be nice to other people; and if one of the other people happens to be a salesman, the way to be nice is to buy something. Finally, we have the gratification of desires and the anticipation of enjoyment in the case of consumer buying, and the expectation of profit in the case of business buying.

Most sales managers and salesmen do not appreciate the strength of this primary desire to buy. They are inclined to be obsessed by the fact that people do not seem to buy eagerly and without hesitation, and they are accustomed to thinking in terms of prodding people to buy, principally on the merits of the products and services which they sell. Consequently, they do not give enough attention to eliminating the deterrents and thus unleashing the buying urge.

As a matter of fact, there are many reasons why people ordinarily are not ready buyers. Consider, for example, such deterrents as doubt occasioned by conflicting claims on a prospect's limited money, time, interest, space; fear of being sold things not wanted or needed, based on past unfavorable experience with salesmen; caution and hesitation, springing from the desire to be sure of a good bargain; habit, that is, always buying certain products from certain sources—a much stronger deterrent than is usually realized; and so on. All these factors give occasion for "resistance," sometimes conscious but more often unconscious; and the composite result is that the prospect reacts adversely when he thinks he is being sold, being pushed into a decision. Conversely, therefore, to the extent that a prospect can be made to feel that he is reaching his own decision, the buying urge is free to express itself. It is this unleashing of the buying urge that gives such strength to the low-pressure techniques.

Lulling Resistance

It should be recognized immediately that the word "resistance," although used in this article because it is a regular part of selling parlance and because there seems to be no suitable substitute, is too general to denote accurately what we mean by it; namely, the emotional state of mind—fear, doubt, caution, or whatever it may be—which in a particular sales situation keeps the prospect from buying as readily as he otherwise would. Excluded from our concept is any "holding off" due to a rational consideration of the wisdom of the purchase. Of course this emotional state of mind may well be nurtured by actual unfavorable experiences with selling in the past, and it may well be prompted by wholly logical reasons which make it ill-advised or impractical for a prospect to make the specific purchase. Remember, too, that the prospect may tend to rationalize, expressing what are largely emotional reactions solely in terms of logical deterrents to the purchase ("I can't afford to buy"). Nevertheless, there is this, shall we say, disinclination to buy which is primarily emotional and which goes distinctly beyond reflecting the time and effort required to appraise a possible purchase rationally; and that is what we mean by "resistance" in this article.

Low-pressure selling gains effectiveness not only by virtue of the fact that it avoids rousing increased resistance in the way in which high-pressure selling does, but also because, if planned with care, it can exert positive action toward lulling whatever resistance is already present. In this connection, the delayed-action approach should be referred to again. Perhaps a more striking example is the way in which the indirect approach can be adapted to low-pressure selling.

EXAMPLE: INDIRECT APPROACH

There are many variations of the indirect approach, but the common characteristic is that the stage is set in such a way as not to stress the imminence of the selling attempt. The idea is that a strong head-on attack is likely to alarm the prospect and cause unnecessary resistance.

An extreme form of the indirect approach, with overtones reminiscent of high-pressure selling, is when the salesman calls in overalls, says he is sent to service a piece of equipment, finds something wrong (not necessarily honestly), and recommends a new purchase. Another variety, perhaps not so far over the border line of good ethics, is the use of disguised and fancy titles, anything but plain "salesman," to conceal the salesman's business until the last possible moment. Such methods ("tricks" is a better word) are extremely questionable. They obviously cannot be used successfully in any kind of selling which depends on the development of goodwill over a period of time. Furthermore, they ignore one of the basic requisites of effective low-pressure selling: sincerity.

Such an approach, let it be emphasized, cannot have the purpose of trying to take advantage of the customer through a ruse if it is to be considered as genuine low-pressure selling. There should be no idea that the salesman is, so to speak, sneaking up on a prospect, deluding him into thinking that he is not being subjected to a selling attempt, and then getting him to say "yes" in a moment of false security. That is clearly the opposite of letting the prospect reach the buying decision principally through his own rational thought. Nor are such tactics necessary. There should be no reason to apologize for selling (that is, for the use of persuasion in the exchange of money for goods) either to society as a whole or to an individual prospect in a particular selling attempt.

Applied wisely and with good motives, the indirect approach lulls resistance in the sense of decreasing the effect of what after all is largely an emotional attitude unrelated to the question of the merits of the particular purchase.

To be specific about the particular tricks just mentioned, it is the author's contention that, especially in dealing with businessmen, a salesman should divulge his real identity and mission at the very beginning of a sales interview. Such frankness will stand him in good stead. The prospect is difficult to fool, and he knows that his caller is not there just for pleasure or with the altruistic desire to help him somehow at no expense. So the frankness merely admits what the prospect probably already knows or suspects and capitalizes on it by showing that no pretenses are being made. Moreover, such a demonstration of matter-of-fact, straight-forward dealing is not inconsistent with making the prospect feel he is reaching the buying decision himself. Indeed, it is more likely to be a positive help in that direction since it is in itself an unspoken argument that the salesman sees no reason for the prospect to show resistance.

Furthermore, and speaking more generally, there are plenty of maneuvers of an indirect type which are perfectly ethical and animated by sincerity—in other words, good examples of low-pressure selling. We can cite, again from the insurance field, the use of an offer to analyze the prospect's insurance needs or to "plan his estate." Many insurance companies do a very thorough and objective job in preparing such analyses, not hesitating to recommend types of insurance which they do not sell or even to approve of competing companies' policies which are similar to their own. If carried out sincerely, and that implies adequate knowledge and care, such an approach is extremely effective in lulling resistance—even though, of course, the prospect knows perfectly well that the ultimate aim of the salesman is to sell him insurance. The author remembers clearly, and still with a warm feeling after the lapse of a good many years, the occasion when an analysis of his "estate" was presented to him with the recommendation that he was carrying enough insurance at the time in relation to what he could afford financially. Needless to say, when subsequently he was in a better position to buy insurance, the salesman who had made the analysis got the business. (It should be noted that in this instance there is also an element of the delayed-action approach.)

Opening the interview by means of a question designed to start the prospect talking belongs in the same general category. It serves the purpose of securing attention and arousing interest; of putting the prospect at ease; and, if the salesman is adroit, of leading the conversation to a point where mention of the product being sold seems to come in almost automatically. A specific instance of this would be where a truck tire salesman, after introducing himself in his true colors, begins by asking the prospect if he has had much trouble with breakdowns along the road. But let it be emphasized: the salesman must be patient; he must have interest, and must be prepared to show interest, in the whole gamut of truck maintenance problems; his inquiry must be backed by both knowledge and sincerity; and he must depend on his own skill in developing the conversation to the proper point.

This particular example of using a question to lead indirectly to the purpose of a sales call and thus lull resistance is tied in with the customer-problem approach. The question technique can be used in other ways, and the customer-problem approach does not need to begin with a question or even to be carried through indirectly; yet the two sets of tactics work well together. Furthermore, as mentioned earlier, the customer-problem approach is the clearest crystallization of low-pressure selling. Because of its comprehensiveness and wholeheartedness, it is the most likely to make the prospect feel he is reaching the buying decision himself, and thus requires mention in this discussion of the primary buying urge and how to unleash it for selling purposes.

Focusing on the Objective Rather Than on the Details

Particularly if we think of the customer-problem approach, we can see another reason for the effectiveness of low-pressure selling. Because it is based on sincere concern for the prospect, it leads him to the point of buying by setting up an objective toward which his mind moves naturally rather than by trying to work him through all the necessary mental stages one by one. The latter course depends on a degree of preciseness which is hard to achieve. Even if we could be sure that there was a definite sequence of mental reactions through which every prospect should pass as he decides to buy (more complicated, no doubt, than the traditional "attention, interest, desire, conviction"), and even if we knew just what they were, it would be hard to separate them in actual practice, harder to follow the prospect's course through them, and hardest of all to provide the proper stimulus for each of them at just the proper time.

Much sounder and much more fruitful than relying on any such "psychological" analysis of selling is the threefold process implied in the customer-problem approach: (1) What is the customer's need or want? (2) How does my product fit that need or want? (3) How can I best demonstrate the relationship between the two? Such a process has these distinct advantages: (1) It keeps the salesman's mind on one central purpose, yet allows adaptation to individual cases. (2) It suggests the motives that can best be appealed to in making a sale. (3) It does not arouse so much new resistance and may even lull resistance already present. (4) The completed sale leaves the customer satisfied.

In other words, low-pressure techniques gain added effectiveness because they are suited to the actual selling tasks of individual salesmen. In this connection, it should also be mentioned that the bugaboo of salesmen, closing the sale, may actually be easier with low-pressure techniques. To the extent that the prospect is made to feel that he is reaching the buying decision himself, and primarily through a rational process of thought, there is less need of extra push to establish "conviction" in his mind just before the salesman asks for the order. In the author's opinion, this matter of conviction is not generally understood. Being convinced is a state of mind which most buyers need to assume before giving the irretrievable "yes" to the salesman. It results from a final questioning and justification of the wisdom of the purchase, and as such it is primarily rational—at least more rational than the desire for the product, which may have been built up by the salesman largely on the basis of emotions. Therefore, in high-pressure selling with heavy emotional appeals there is likely to be something a little different and a little extra that must be added to the prospect's thinking at the next-to-last minute. In low-pressure selling, on the other hand, much of this last obstacle to the buying decision will often have been disposed of gradually as the sales presentation proceeds, and the prospect is already in the rational frame of mind to accept conviction—or even better, to convince himself.

SPECIAL CIRCUMSTANCES

Most of the observations made up to this point are applicable to low-pressure selling in general. From the various illustrations used, however, it should be evident that certain situations lend themselves better to such selling than do others. For the benefit of those who wish to consider specific selling jobs, let us try to draw together some of the determining factors. (1) Whenever continuing goodwill is at stake, as would be the case in building up a route where calls will be made with relative frequency, then the "friendliness" of low-pressure selling will be an aid. (2) Whenever specialized knowledge is of value to customers, e.g., technical help or market information, then the customer's feeling of confidence in the salesman and his company, engendered by low-pressure techniques, will facilitate sales. (3) Whenever the purchases involved are of more than ordinary significance to prospects, in dollars and cents or otherwise, then the feeling of having arrived at a well-considered decision will often be the affirmative factor. (4) Whenever the buyer intends to use the product or service for business purposes, such as resale for profit or use in industrial production, then the opportunity to apply rational judgment will re-enforce the desirability of the purchase. The list does not pretend to be complete. Moreover, there are plenty of selling situations where, even without such special favoring circumstances, low-pressure selling will still outpull high-pressure techniques. After all, low-pressure selling owes its effectiveness to the fact that it is based on human nature.

What about the influence of different economic conditions on the effectiveness of low-pressure techniques? More specifically, are they likely to lose some of their strength in periods when buyers are balky? On the contrary, they should be stronger since then there is all the more need to lull the resistance of those who feel they must make their buying decisions with greater wariness and objectivity of judgment. All in all, the conclusion is justified that low-pressure selling has a tremendous potential of effectiveness—great enough, in the author's judgment, to provide the measure of difference between success and failure in our postwar plans for increased distribution of goods. Certainly low-pressure selling, particularly in the form of the customer-problem approach, is pointed in the right direction, toward the satisfaction of the economic needs and wants of ultimate consumers, which from the point of view of society is the only long-run justifiable end of both production and distribution. Furthermore, while like all selling effort it involves expenditure of money to persuade people to buy (the inevitable counterpart of purchasers' freedom to buy when, where, and what they will), this particular type of selling does add validity to the idea that the costs of distribution which society bears, although not showing up as tangible values in products, are justified by intangible services rendered to the economy; and at the same time it may help to reduce these costs through its greater effectiveness.

Whether its potential can be realized, however, depends on whether sales managers are willing to tackle the increased problems of selection and training of salesmen.

Implications for Sales Management

It was mentioned earlier that low-pressure selling runs the danger of being ineffectual unless the absence of high pressure is compensated for by positive effort. It should be clear by now that more is required of salesmen using this technique than merely being pleasant—although it is important here, certainly more important than in high-pressure selling, that the salesmen's personal habits and manners create a favorable impression with prospects, since so much is staked on not arousing resistance. It should also be clear by now that more is required of salesmen than a series of soft and subtle little stratagems to replace their old exaggerated claims and emotional appeals; they must utilize something strong and purposeful, like the customer-problem approach.

All this puts a heavy burden on sales management in the selection and training of salesmen. This task is both more important and more difficult with low-pressure selling. Low-pressure selling may have some of the powers of the magic lamp, but it takes a good deal of hard rubbing to produce the jinni. For the purpose of this article it will have to suffice to mention the management problems raised by low-pressure selling and to indicate the general direction in which solutions must be sought. As a matter of fact, the nature of low-pressure selling is so flexible that most specific problems have to be handled in terms of individual companies.

Selection of Salesmen

A different type of salesman is needed. No attempt can be made here to specify his qualifications since there are so many factors to be weighed and taken into account in individual selling jobs, but the general outline indicates a decided departure from the hail-fellow-well-met, back-slapping, story-telling, loud-laughing type of the traveling salesman and farmer's daughter era. Indeed, many sales managers have already found that the ambivert or even the near-introvert is likely to be more successful than the extrovert.

Above all, a more intelligent type is needed for low-pressure selling. A normal man will not find it unnatural or difficult to assume the habit of thinking in terms of his customers' problems, but he will have to do a greater amount of more subtle thinking—adapting to individual cases and swinging sales on finer points. Certainly he cannot operate by rote and ritual.

Clearly it will take more care and effort to select such men. There is no point here in going into the controversial subject of how prospective employees can best be appraised, but it will do no harm to point out that in this case the qualities sought may not be readily apparent, and that a well-planned system of detailed application forms, multiple interviews, and psychological testing seems indispensable.

Training of Salesmen

It is relatively easy to teach high-pressure techniques. Because the essence of that approach is that the prospect submits to something imposed on him from without, it is possible to standardize the sales presentation—to formulate it in the home office and show the salesmen how to do it. The opposite is the case with low-pressure selling. Although of course something can be prepared in the way of suggested openings, possible answers to objections, and so on, any hint of a "canned" sales talk, learned and repeated from memory, will ruin a low-pressure approach completely.

Two principal duties devolve on the sales manager who would have his salesmen do effective low-pressure selling. In the first place, he must give them knowledge about the company's products and policies and about the customers' needs and ways of doing business. He must give them everything he can think of, and then encourage them to come back at him with questions and requests for additional information. Such knowledge will give a feeling of confidence to the salesmen—and to the prospect too when he sees it in evidence. Such knowledge is indispensable for low-pressure selling in general and the customer-problem approach in particular.

In the second place, the sales manager must train his salesmen to think—to think about their customers' individual needs and wants and how the company's products can fit those needs and wants. This is no easy task. How can it be accomplished? The author knows of no way that has ever been successful in training the ordinary run of human beings to think except by making them practice it in group discussions. For our present purpose this would mean analyzing and arguing example after example of pertinent problems, preferably drawn from the actual experiences of salesmen in the field. Perhaps some of the new developments in visual education will be helpful in this connection, particularly the use of specially made movie shorts. There is no surer way of putting problems across than to present them in a form as close as possible to that in which they actually occur, and the greater vividness and realism thereby secured will stimulate the ensuing thinking and discussion.

Leadership

There is the further question how salesmen can be controlled and directed in the field so that they will make the best use of low-pressure techniques. Several areas for possible action suggest themselves. Salesmen's reports can be used with this end in view; perhaps one report should be designed with no other purpose than to high-light the importance which management attaches to results other than immediate sales. Some of the sales meetings can be devoted exclusively to analysis of customers' needs. In this and other ways, relations between salesmen and their supervisors can be made more direct and intimate.

Certainly, too, there must be a logical tie-in with the plan for compensating salesmen. Of course no sales manager can expect that he will ever have a perfect compensation plan, since inevitably it will be a compromise between objectives that are by nature contradictory. With low-pressure selling it is especially difficult to strike a balance between (1) stability and assurance of income, characteristic of straight salary, which make it easier for a salesman to engage in action not necessarily productive of immediate sales and to plan on the course that will bring in more sales and sounder sales in the long run, and (2) strong incentives, like commissions, which are useful in keeping a salesman at the peak of his effort yet may encourage him in a tendency to think only in terms of quick sales. Obviously, with low-pressure selling there is both more need of developing the long-run view and more danger of encouraging relaxation of effort; both objectives of the compensation plan become more important! However, in general it can be said that the logic of low-pressure selling points away from any emphasis on automatic incentive features—and indicates a bigger role for the sales manager, who must use other means to keep each salesman working to the best of his ability.

Above all, the sales manager must take extraordinary precautions to avoid some of the dangerous situations which might otherwise arise in connection with low-pressure techniques. He must make sure that the salesman, put more on his own and deprived of standardized props, does not flounder. He must make sure that the salesman does not "go with the wind"—hoping sales will develop rather than planning and working for them. He must make sure that the salesman does not take refuge by going over so completely to the customer's point of view that he neglects his primary function of selling the company's products.

To carry through this difficult assignment requires leadership and exercise of teaching ability. For it is harder to "drive" salesmen when the selling activity itself seems to have a slower tempo, and no automatic devices can do the trick.

Yet if the sales manager can succeed in educating his salesmen, and continually re-educating them, to the fact that low-pressure selling does demand as much positive, purposeful, planned action as high-pressure selling—and indeed more, in the sense that it must be deployed with greater skill and must have more effect for the same amount of obvious exertion—then low-pressure selling will actually bring higher productivity in relation to the time and effort spent. Furthermore, because the field is difficult, the rewards for superiority will be greater.

As mentioned before, the burden on sales management is heavy. But it is a burden which will reward those who take it up, for low-pressure selling, wisely used, can be the tool to increase sales. And let it not be forgotten that management has the clear responsibility of seeing that effective selling does accelerate the distribution of goods—with personal selling, judged by the portion of the sales dollar that goes to it, still the most important aspect of distribution. If that responsibility is shirked, not only will individual companies fall behind in the bitter competitive struggle that probably lies ahead, but the whole country's hope for a more productive economy will end in disillusion.

Concluding Note

There is little that the author cares to add at this point. He would like, however, to cover himself for some of the exaggerated statements and overdrawn distinctions he has made. Nothing is quite so black or white as he often has tried to make it look. For example, he has failed to say explicitly that there are bound to be selling situations where a judicious admixture of high-pressure techniques can be employed effectively and without harm to either the customers or the salesman's company. Even worse, he has talked as if most selling were soliciting new customers, whereas actually the bulk of selling activity consists of calling on old customers. Nevertheless here too most of the observations made in the article apply, since the task of keeping old customers in line and increasing the size of their orders is still selling. As a matter of fact, it is this field that lends itself best to low-pressure selling, and it is here that many of the low-pressure techniques originated many years ago.

A further note of humility is also in place, in behalf of all salesmen as well as the author. One should never be dogmatic about selling. It is too closely related to the bewildering variousness of human nature—and this, again, is one of the reasons why low-pressure selling, with its flexibility and adaptability, is both more effective and more fun. What more appropriate conclusion to this article could there be, then, than the following story, which has always struck the author as a perfect illustration of (1) why never to be sure about what will happen in selling and (2) the dangers of not using the customer-problem approach? Let him tell it in the first person, since he played the central, if not heroic, role:

I had bought a carload of peas from a well-known canner, which were slightly substandard—in other words, a little wrinkled and tough—and which the canner was not willing to pack under his regular brand. At that time, nationally advertised brands of peas were selling at about $2.25 a case; unadvertised but reasonably good brands were selling at $1.95. I had bought these peas so that, if I could turn them over fast, a price of $1.60 a case was satisfactory. I had a customer out in the country, a successful grocer accustomed to buying in large quantities, who I thought might be a good prospect. After figuring out how I could best approach him and deciding to stake everything on the price appeal, I got in my car and went out to call on him.

When I came into his store, I left the sample can of peas which I had brought with me in the car. As soon as he was free, I started to work with a price of $1.90 (thinking to myself that anything I could get above $1.60 would be "gravy"). Of course, the first question he asked me was, "Where is your sample?" So rather reluctantly, protesting that the name of the canner should be enough for him, I went out to my car to get it. We opened the can; he tasted a few, rolling them around in his mouth in a sort of judicious way, then chewing them rather deliberately. I said, "Pretty good, aren't they?" He countered, "Sort of tough, aren't they?" I said, "Well, not really; and at that price they are a bargain"—or words to that effect. After almost an hour of haggling, we had reached the point where he wouldn't go any higher than $1.60 and I wouldn't go any lower than $1.65. So I sold the carload to him at $1.62½ a case—a whole 2½ cents above the minimum price I had set myself.

And I felt pretty good about my sale. That is, I felt pretty good until he turned toward me, and smiled, and said: "You know, you made a bad mistake. I would have been glad to pay a premium for those peas instead of getting them for a bargain. I have been looking for peas exactly like that for a long time. The farmers that live around here like to cook their peas for a couple of hours, and most of the canned peas you get these days fall apart if you cook them that long."

USE OF SALES APTITUDE TESTS

BY J. ROBERT HILGERT

The question of the value of sales aptitude tests is very controversial. The articles on this subject appearing in scientific journals and trade magazines are both sketchy and highly contradictory. Nevertheless sales executives have been showing an increasing interest in testing during the past five or six years. There are several reasons for this trend. One lies in businessmen's realization of the widespread use of all sorts of tests for determining the aptitudes of recruits in the armed forces. Another lies in the fact that, through curtailment of civilian goods manufacturing during the past four years, many sales organizations have been reduced to a skeleton crew. Consequently, when the manufacturing of peacetime goods of all types is again resumed, many concerns will have to hire almost a complete new sales force. Because the trend is away from rule-of-thumb procedure, many sales executives are looking for more scientific sales selection techniques.

But before the use of sales aptitude tests can be recommended, there are some major points which need to be cleared up: (1) To what extent are tests used for selecting salesmen? (2) What types of test are used? (3) What specific benefits do users claim for tests?

In order to secure information on these points, the writer made a critical study both of the published material and of the actual opinions of sales executives. Altogether 500 questionnaires were sent out to officers, mostly vice presidents in charge of sales or general managers, of companies representing a cross section of many different types of industry. In addition, 50 of the executives were interviewed in person. This article is based largely on material gathered from that study.

HOW WIDELY ARE TESTS USED?

Despite the fact that hiring of salesmen is at a very low ebb at present, sales executives are keenly interested in sales testing. More than 70% of those to

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Source: *Harvard Business Review*, Vol. XXIII, No. 4 (Summer, 1945), pp. 484-492. Reprinted by permission.

whom the questionnaires were sent replied, and quite a large percentage of the replies from those who do use tests were accompanied by lengthy letters. Yet the final tabulation of the replies revealed the following figures:

Use tests now or when hiring of salesmen is resumed	10%
In the process of experimenting with tests	5
Do not use tests	85

Clearly only a small percentage of concerns are now using tests for selecting salesmen. However, this is not of itself a reflection on the successfulness of tests. By far the largest part of the reasons given for not using tests merely related circumstances which made their use less necessary or less desirable in the minds of the officials of the reporting companies. The following generalized statements show the most typical reasons:

1. Our sales organization is small and there is very little turnover in personnel. For that reason we do not have a selection problem of sufficient size to warrant the use of elaborate techniques.
2. We hire only experienced salesmen, people who have demonstrated their ability by selling similar lines of goods. We feel that the salesman's record is all we need.
3. We employ only college graduates (engineering or otherwise) whom we select by going to college campuses. We rely on college performance records and the recommendations of college placement officers, supplemented by a short, personal interview.
4. We have a policy of selecting men who have demonstrated their ability inside the organization. In other words, we select men from the various departments who seem to be potential salesmen.
5. We believe that a carefully planned and exhaustive interview gives satisfactory results without the aid of tests. (In some concerns a half-dozen executives interview the applicant and each notes his estimate of the man's worth on certain designated characteristics.)

Only about 4% of those not using tests stated that they had tried them and found them worthless. At the same time, 8% of those who had never used tests stated that they were definitely interested in improving their selection procedure for salesmen and were reading all the published reports on tests in the technical and trade journals.

FACTORS LEADING TO FAILURE OF TESTS

The fact that roughly 10% of the respondents found sales tests useful in a number of ways, as will be pointed out later, and are going to use them in hiring and training salesmen, while other companies found tests worthless, presents an anomalous situation. Just why did some find tests successful while others found them impracticable? There were two items in the questionnaire that bear on this point: (1) Did you develop the aptitude tests yourself, or did you consult a competent psychologist or sales testing organization? (2) What standard tests did you include in the battery you used? The replies to these questions help to explain some of the irregularity.

Some concerns, after deciding to use tests, just bought a batch of standard tests and tried them out without going through any preliminary preparations: they merely gave the tests and scored the results. Others used sales aptitude tests that were mentioned in trade journals. Still other concerns used part of the Life Insurance Sales Research Bureau's Aptitude Index, together with other tests, in the hope that some practical measurement would be developed. Some reported that they made up a battery of tests which they thought would be practicable. Several hired amateur psychologists and gave them the job of working out a testing program.

A large firm that had negative results from tests offered this observation:

> Some years ago an organization sold us a few of these aptitude tests which we tried out and which we found unsatisfactory. Therefore, we did not go ahead and use them as we had planned. They reported that one of our very best salesmen was not very good, and they did not recognize that he spoke Polish and some other languages which gave him a great advantage in handling his trade and made him a valuable man to the company.
>
> They did, however, pick out one man as being an outstanding salesman, much to everybody's surprise, because his record was not of this character. Within three weeks after taking the test, this salesman died as a result of a tumor on his brain.

A national company with several hundred salesmen had this to say:

> A few years ago we employed Mr. ———, a graduate student at ———, to work out a test program for us. In practice this test did not seem to substantially improve our selection. It is not now in use. Our experience with this student convinced us that a test must make sense if it is to be used by our field management group, as well as by prospective employees. The questions included many such questions as: "Do you mind the odor of burning hair?" Salesmen and most of their immediate superiors are not psychologists. Such questions convinced them that both the salesmen test and top management are a little off.

The following observation summarizes the thought of a number of sales executives, both those who have tried tests and found them useless and those who have never tried any testing:

> If and when a practical test is developed which comes to our attention, we will include it in our hiring program. If you should develop or hear of a successful sales aptitude test, please let us know about it. In the meantime we shall keep on reading all the published articles we can get hold of in the hope that we will get a practical sales test so well developed that it will help us in our postwar selection of salesmen.

In other words, many are sitting on the side lines waiting for a fool-proof test to be developed, a test which can be successfully used like a formula.

Requirements for Successful Use

In view of the experiences with tests like those just reported, it is obvious that many executives do not have the remotest conception of the requirements for successful operation of a testing program. They seem to have the conviction that if they grope blindly long enough, something will turn up that will somehow work; that by continuous experimenting with various tests a series of statistics can be evolved which will disclose a selection pattern that is somewhat superior to chance. Such a procedure would indeed take a long time, and without much prospect of success, since there are many different types of standard test on the market. The Psychological Corporation, for example, claims that there are over 30,000 tests catalogued, and other sources indicate that 4,000 tests are now in use.

In particular, many executives do not realize that the successful use of tests for improving sales selection is a highly complex and technical task and that the analysis and interpretation of tests is not an amateur psychologist's job. There is a saying that no test is any better than its interpretation, and this is very true. The interpretation of psychological tests is a matter of judgment which can come *only from wide experience in their use*, plus a thorough knowledge of their limitations and an essential understanding of people.

Successful handling of tests requires a person with these qualifications, who also knows the traits and qualities needed for various types of selling and the various tests or batteries of tests that measure those traits and qualities. He must realize, too, that every individual business firm is different from all others, even in some ways from those of competitors in the same line, and that the "custom element" in every concern makes its own selling problem to that extent different from all others.

What Kinds of Test Are Used?

An impressive number of tests were listed on the questionnaires as having been used. The following ones are most frequently mentioned:

Otis Self-Administering Test of Mental Ability
Bernreuter Personality Inventory
Strong's Vocational Interest Blank for Men
Social Intelligence Test by F. A. Moss, T. Hunt and K. T. Omwake
How Perfect is Your "Sales Sense"? by Canfield
Washburn Social Adjustment Inventory
Wonderlick Personnel Test
Bureau Test VI—Mental Alertness
Interest Inventory for Sales People, The Personnel Institute, Inc.
Vocational Aptitude Examination, Type E-A by G. U. Cleeton and C. W. Mason
Composite Inventory and Examination by Verne Steward
Aptitude Index by Life Insurance Sales Research Bureau
Humm-Wadsworth Temperament Scale
American Council on Education Psychological Examination
O'Connor's Vocabulary Test
O'Rourke Mechanical Aptitude Test

There was absolutely no uniformity regarding the number and type of tests used. Some companies used only two. Others tried as many as four. Then there were quite a few concerns which employed an aptitude testing organization using a battery which included six standard or stock tests (the first six on the above list). The best results were reported by those concerns—40 of them—which employed the testing organization with the battery of six tests.

Because sales executives are generally aware of the fact that there are different types of selling and that salesmen must have different patterns of aptitudes for successful performance in each type, many feel that a different set of tests must be used for each type. Some even feel that tests must be tailored for each organization where they are to be used. However, neither one of these assumptions is necessarily correct; as will be pointed out later, the differences in selling tasks can be taken into account by proper interpretation of the tests.

The theory that a different battery of tailored tests is required for effective testing is clearly not borne out by the experiences of those who returned the questionnaire. The 40 concerns already mentioned got highly satisfactory results from sales aptitude testing with the same battery of standard tests. This is all the more striking because the concerns in question represent a wide variety of different industries: radio and telephone equipment, automobile accessories, heating equipment for industrial use, office equipment, cash registers, drug and hospital supplies, hardware, abrasives, food products of all kinds, building supplies, wines and liquors, steel products, insurance, services.

Characteristics of Successful Salesmen

These varied lines require many different types of selling and thus different "patterns of aptitudes," experience, and education. Why were the same six standard tests effective for selecting salesmen for the various types of selling? It is because they measured the traits and qualities that characterize, in differing degrees, all successful salesmen.

By agreement of psychologists and practical counsellors offering testing service, the traits and qualities found in successful salesmen are:

1. Emotional stability: This refers to the ability to take turndowns without losing self-control or getting depressed.

2. Self-sufficiency: A salesman possessing this trait is resourceful in meeting new situations and in attacking problems; he is a person who can work without direction "on his own."

3. Objective-mindedness: This implies that the salesman has the ability to read events unaffected by his own action or feelings, and the power to express facts without distortion from personal prejudice or self-interest.

4. Dominance: This is the opposite of submissiveness; a salesman possessing dominance has "fighting qualities" and has the ability to control and direct interviews.

5. Self-confidence: This is almost a self-defining term; specifically it means that a person with this trait has confidence in his own ability to achieve what he undertakes.

6. Social-mixing qualities: These qualities simply show that the person desires and needs human companionship in groups.

7. Tact and diplomacy: These are two very important qualities which indicate that the person has the ability to handle delicate interhuman situations with such smoothness as to instill a maximum of good feeling in others.

8. Sizing up people in situations face to face: This refers to the ability to recognize during the course of an interview the mental and emotional state of others from what they say, their facial expression, and the way they act.

9. Sense of humor: This refers to the person's ability to see humor in situations in which he himself is involved, to take kidding.

10. Sales aptitude (a specific term, not to be confused with sales aptitude in general): This means that the person has an interest in selling and at the same time has a natural flare for convincing others.

11. Mental ability: This shows up in speed of thinking, quality of thinking, and manner of following instructions, which are definitely factors that are significant in selling.

PATTERNS OF APTITUDES

Even though it is not necessary to use different batteries of tests, nevertheless the testing must measure the different patterns of aptitudes which are needed for different types of selling.

For example, a specialty salesman selling to consumers door-to-door such products as vacuum cleaners, flat silver, home insulation, and so on needs to rate high in objective-mindedness and self-confidence but low in tact and diplomacy. In the matter of mental alertness, average-to-low in speed of thought may be desirable; otherwise he would grow restless, question the company's "canned" sales talk and policies, and probably quit his job.

On the other hand, the sales engineer selling items like air-conditioning, plant insulation, and conveyor systems must have quite different traits to be a successful salesman. He must have a fast-thinking mind so as to be able to see solutions to complicated problems that confront him from time to time. It is also necessary that he rank high in social-mixing qualities because he may have to work on one sales proposition for a long time—a month or even several years in some cases. Although he may rate fairly low in sales interest as selling is commonly considered, he must rank high in sales sense in order to estimate how prolonged negotiations are coming and whether or not he is making any progress toward getting the order.

These illustrations indicate the pattern of aptitudes for two widely different types of selling. They show that different combinations of traits are required for different selling tasks. A battery of tests properly selected will measure the aptitudes of all types of selling. But—and it is a big "but"—the one who analyzes and interprets the test results must know in advance what "pattern" is needed for the particular sales organization for which he is testing, and he must also be able to determine from the test scores which applicants have the pattern. The test is "tailored" by the interpreter.

VALIDATION

One of the major problems confronting users of tests is the difficulty of validating them, that is, of making sure they measure what they are intended to measure. Because testing in essence is measuring against a standard believed to be related to performance, validation cannot be effected without knowing what that standard is. In other words, if tests are to be employed to single out good salesmen or reject those who are unfit from a group of applicants, it is necessary to determine first a criterion of successful sales performance.

Although sales volume is often assumed to be the measure of a salesman's success, many sales executives will not agree that it is a sound criterion. There are usually many other factors of importance to be considered in a salesman's record. Sales volume, therefore, probably never can be used as the sole criterion. O. H. Ohmann of the Tremco Manufacturing Company found that "it was practically impossible to tell from the records that were available who was a good salesman and who was not. Sales were determined by many factors such as advertising, territory differences, jobbing connections, etc." [1]

That even in life insurance selling, where the salesmen are paid on a commission basis, sales volume is not a satisfactory measure of a salesman's true worth is affirmed by T. M. Stokes, Metropolitan Life Insurance Company:

> We used three criteria that could be expressed quantitatively, namely, length of service, amount of ordinary and accident and health insurance placed, and increase in industrial insurance sold. The quantitative criteria, however, do not accurately measure the success of the salesmen. Other factors, such as the quality of the agent's service to prospects and policyholders and his cooperation with management and fellow agents are important.[2]

Those concerns with the highest degree of success in sales testing reported without exception that they followed a validation procedure like that of the Aetna Life Insurance Company, in which the "ratings" of the sales managers are used as a criterion of successful sales performance.

The first step in this validation procedure is a job analysis to determine the nature, duties, responsibilities, and opportunities of the salesmen's jobs. From this analysis are visualized the characteristics, the personal traits, the knowledge, the training and experience that the men should have to do their work most effectively. With these factors in mind, the sales managers then rate their salesmen's performance—not looking at their sales alone but also at their all-around value as members of the sales organization, length of service, cooperativeness, loyalty, and the like. On the basis of these ratings the salesmen can be classified into groups such as "best," "average," and "poor." Representatives from these groups are then given the battery of tests; the tests are scored; and the test results are compared with the sales managers' ratings of the men.

The concerns which used this kind of validation procedure reported correlations ranging from 75% to 88%. In other words, the test results for four out of five men examined checked precisely with the ratings of the sales managers. When so close a correlation as that is obtained after testing several groups, the validity of the battery of tests is established. The inference to be drawn from this experience is that if the test can classify and determine the pattern of sales aptitudes correctly for four out of five men already employed, it is highly reliable in selecting or rejecting applicants for sales positions.

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[1] O. H. Ohmann, "Research on the Selection of Salesmen at Tremco Manufacturing Co.," *Marketing Series No. 45* (American Management Association, 1941), p. 6.

[2] T. M. Stokes, "Selection Research in Sales Organization," *Journal of Applied Psychology*, February, 1941, pp. 44–45.

WHAT BENEFITS ARE CLAIMED FOR TESTS?

A tabulation of the various advantages or benefits reported by those who used tests successfully can be summarized as (1) improving selection, (2) aiding supervision and training, (3) facilitating promotion.

IMPROVED SELECTION

Aptitude tests screen out those who are unfit or likely to fail and help to select those who can be successfully developed. In this way turnover is cut down and training expense is reduced. Two typical statements corroborating this claim are:

> Limited experience indicates that 8 out of 10 tested "make good" as compared with 4 out of 7 in the case of untested salesmen.
>
> Spot check of a group of new salesmen hired and trained under substantially the same circumstances indicates that a salesman recommended by the test battery apparently has twice the chance of developing into a successful representative than the one not so recommended.
>
> In appraising this statement, it should be borne in mind that it is really an understatement of the value of aptitude testing, since new salesmen hired despite an adverse test report must have some extraordinarily strong offsetting qualifications, such as exceptional appearance, personality, experience, or previous record of success.

Tests are especially effective in improving selection and reducing turnover in the far-flung decentralized sales organizations in which branch or district managers have charge of hiring salesmen. Such managers are not usually skilled interviewers and cannot see all the shortcomings of sales applicants; when their judgment is aided by tests, their selection of salesmen can be materially improved. George L. Todd of The Todd Company said:

> Our conclusion is that aptitude testing in itself seems to have been an instrument for improving the judgment of our branch managers. While the test results are far from being infallible, they are less fallible than personal conclusions. This fact demonstrated in practical experience, not only meant that aptitude testing has proven an offset or a check on personal prejudices of branch managers, but has tended to make them more aware of and better able to minimize the factor of prejudice.
>
> Still we must admit that aptitude testing is not completely infallible—while science can measure accurately in a great many cases, it cannot always tell how to evaluate the findings, nor can it tell all the things that we must know about a man to complete a full appraisal of him.
>
> There are excellent men in our organization today who would not have been employed if our testing had not been tempered by judgment. However, when confronted with a choice between being guided wholly by judgment and consequently missing some good men, and being guided wholly by judgment without the benefit of testing, *I'd sell out the judgment and take the testing.* Yet I in no way minimize the vital importance of judgment.

Nevertheless, sales testing, if it is to bring about substantial improvement in selection of sales personnel, must be properly used *in conjunction with* two other selection techniques, the personal interview and the application blank.

The first step in any good selection procedure is the interview. The sales executive must determine from the interview whether an applicant is the kind of man he would like to work with and whether he is the type that meets the job specifications. From the application blank his background, including his education, marital status, and experience, can be checked. The aptitude test is the third hurdle in the selection. If an applicant passes the interview procedure and has an acceptable rating on the application blank, he should then be given the aptitude test to measure the traits and qualities which could not be discovered or measured by the other techniques. If the results of the test are also favorable, the man can safely be hired with a minimum amount of risk. If the test report is negative, however, the company had better investigate the man's background and reinterview him to see if any negative factors have been overlooked.

The significance of testing used this way is clearly stated in the following excerpt from an address by Fen K. Dosher, Sales Manager of the Lilly-Tulip Cup Corporation, before the Conference of the Associated Chain Drug Stores of New York in 1944:

> Sometimes the question will come up: if such care is taken in the interview and application blank, why the aptitude test? The answer is very simple: in the case of jobs, the past is not always the promise of the future. The future is always a big, open void; the future belongs to the next unpredictable minute. That next minute is full of emergencies, contingencies, situation, conditions, job requirements and actions by superiors which the individual never faced before in exactly the same way. The aptitude test predicts the probable action of the individual under those unknown circumstances before action is called for.

AID IN SUPERVISION

Some executives who are using testing effectively feel that too much emphasis is being placed on the screening ability of testing, that is, on the ability to weed out poor prospects before they are hired. One sales executive observed that the screening ability "most certainly is helpful, but this is not nearly so important to us as the ability to work far more satisfactorily with a good man once we get him."

The personality portrait as revealed in the analysis and report of a testee aids in training and supervision after the man has been hired. Regarding this particular function a vice president employing some 200 salesmen said this:

> To us there are two phases of this subject of aptitude tests. First, our experience has been that the battery of tests used in selecting is approximately 75% to 80% effective in telling us whether or not a man will be successful in our work.
>
> Second, if this were the only result obtained from aptitude tests I do not believe that we would be as interested as we are. An even more important thing to us is the use of an analysis which results from the aptitude test and the *information* it contains. This information makes it possible to work so much more effectively with a good man. No two men are alike and no two men respond to the same type of stimuli. What is effective with one man merely makes another resentful. The analyses which we get from these aptitude tests make it possible for us to use one type of tactics with one man and another entirely different type of tactics with another man. These tests show you what makes a man "tick" and you can sit down and work with him to a surprisingly successful degree.

As an illustration of the kind of analysis referred to in the preceding quotation, the case of an actual salesman is cited:

> From the viewpoint of aptitude and potential productivity Mr. Doe is recommended for employment in the XYZ Company.
>
> Mr. Doe's mental ability portrait is good. He is well within the range of effectiveness for the XYZ Company's sales work.
>
> Personality portrait: Doe can take it when it comes to turndowns, defeats, obstacles, resistances, adverse conditions and competitive situations. Self-confidence, self-sufficiency, ingenuity, and resourcefulness are good, and Doe is definitely the dominant individual. It is thus apparent that Doe's personality portrait is within the range of effectiveness for selling the product of the XYZ Company. However, in working with Doe the following factors, traits and qualities should be observed: (1) Doe may not feel like making an adequate number of calls on enough prospects and users, even if he might make a lot of calls on a limited few. (2) Doe may fold up too soon and in too many interviews. Thus, you can see that Doe will require constant prodding or, in other words, will require the well-known kick in the pants consistently. (3) Doe misinterpreted some significant test questions, so you must make sure that you check into all reports, statements and opinions for the actual facts.
>
> Sales aptitude: Doe's sales aptitude profile is similar to that of most successful XYZ Company salesmen. He knows his way around in sales situations, has ample reserve of sales knowledge with which to help others in their general sales problems.

In both training and supervision on the job such an analysis is very helpful as it indicates the areas of strength and weakness of salesmen and helps in setting up proper corrective measures.

FACILITATING PROMOTION

The addition of several more tests to the regular battery is said to make it possible also to spot potential executive talent among sales applicants. This is often quite helpful, since very frequently branch or district managers are chosen from the ranks of the salesmen, yet a salesman's sales record is not necessarily a criterion of his ability to manage salesmen. The talents required for supervising are not identical with those of selling.

SUMMARY AND CONCLUSIONS

There is a widespread interest in sales aptitude testing. Sales executives feel that hiring of salesmen is going to become a real problem as soon as civilian goods are again produced on a large scale. During the past five or six years many organizations have begun to experiment with tests. Many others are contemplating using tests as a regular hiring procedure in peacetime.

Varied results have been obtained by those who have tried tests. Some have been definitely disappointed and have resolved to continue with the traditional methods of selecting their men. A number of concerns, on the other hand, are quite well satisfied with the benefits of testing, feeling that they have improved their selection substantially, and expect to use this technique regularly when hiring is again resumed.

The success of sales aptitude testing depends entirely on the kind of tests that are used and the way in which they are interpreted. Their administration and interpretation are primarily the job of a professional testing organization which is staffed with competent psychologists and experts in selling, an organization that has had the experience of testing thousands of salesmen in various types of selling. Moreover, it is not necessary to develop tailored tests for each individual concern; the standard psychological tests now available are entirely adequate for the job if properly handled.

Sales testing can never displace judgment. Both the interview and the critical study of the personal history items in the application blank must be continued in the selection program. At the same time, tests can materially supplement these other selection tools.

VIII. PRICING

SOME NOTES ON DEMAND

The demand for a commodity, as the term is used by economists, is the willingness to exchange other commodities for it. In developed economic systems, barter is rare, and the demand for a commodity takes the form of offering money and other currency. In any case, demand is a relative term, involving the direct or indirect comparison of other commodities with the commodity in question. Although it is useful, for many purposes, to begin the study of a commodity with the study of the demand for it, the student must remember that economic life does not begin with demand, that demand is dependent on employment and production as truly as employment and production depend upon demand.

It is extremely difficult to obtain exact knowledge of the demand for a commodity or even close approximations to it. The general discussions of demand by economists do not provide any simple formulas which are easy to apply to the facts of a complex and changing world. Some judgment about demand is so important for many business decisions, however, that any aid is welcome. The economists' generalizations are obviously no substitute for the experienced businessman's intimate knowledge of the conditions in his particular trade, but they give the student a useful frame within which he can fit business facts.

To measure demand, the economists take money as the standard measure and refer to price. Money is a satisfactory measure when its own value does not fluctuate, i.e., when the general price level does not change. It is important to remember that demand helps to explain prices only when the general price level is assumed and that *demand and supply really explain relative prices, not the general level of prices.*

Assuming the general level of prices, we measure demand by the prices the buyers are ready to pay for different quantities. *Demand refers to both quantities and prices, not to either of them alone.* A given demand may be expressed in either tabular or diagrammatic form. A demand schedule states the demand situation as follows:

Source: Malcolm P. McNair and Richard S. Meriam, *Problems in Business Economics* (New York, McGraw-Hill, 1941), pp. 82–91, 143–144.

Price	Quantity
$9	1
8	2
7	3
6	4
5	5
4	6
3	7
2	8
1	9
0	10

This means that if the price is $9, one unit will be taken, and if the price is $7, three units will be taken; and conversely, that if only one is put on the market, the price will be $9, whereas if eight are put on the market, the price will be $2. If eight are sold rather than one, it does not mean an increased demand; it means that, with an unchanged buyers' attitude toward the commodity, the price is lower for the larger quantity.

The same demand situation is presented in diagrammatic form in Fig. 1 as a demand curve, *DD′*. The entire situation, i.e., the whole statement of quantities and prices, is referred to as the demand. It is a convention among economists to represent physical quantity on the horizontal axis and price on the vertical axis.

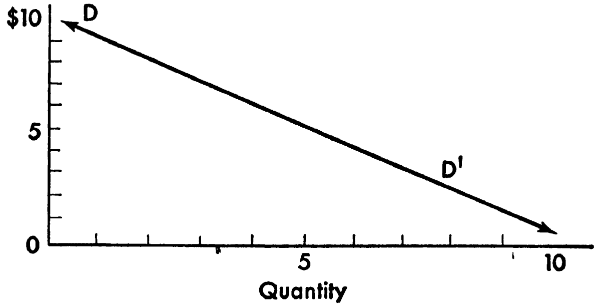

FIGURE 1

The demand schedule and the demand curve both illustrate the general law of demand: *Other things being equal, the larger the quantity put on the market, the lower the price, or the lower the price, the larger the quantity sold.*

An increase or decrease in demand must be represented by a new curve. *An increase in demand means that at the same series of prices as before, increased quantities can be sold.* An increased demand is represented by a new curve, lying to the right of the original curve. A special case of an increased demand is one brought about by the seller through advertising or other sales promotion; this is called, in marketing, the expansibility of demand.

To be distinguished from an increase in demand is the elasticity of demand. Although the general law of demand states that larger quantities bring lower prices, it does not say how much lower. An elastic demand exists when the larger quantity brings a relatively small decline in price; and inelastic demand exists when the larger quantity brings a relatively large decline. In more precise language, *demand is elastic when, with a larger quantity offered, the necessary reduction in price is so small that the total receipts (the net price times the number of units sold) are greater for a large quantity than for a lesser one; and demand is inelastic when, with a larger quantity offered, the necessary reduction in price is sufficiently substantial to make the total receipts smaller. Conversely, of course, elastic demand means that when a smaller quantity is placed on the market the consequent advance in price is not sufficient to increase the total receipts, whereas inelasticity means that with a smaller quantity placed on the market the consequent advance in price is sufficiently great to increase the total receipts. The boundary case is that where the elasticity is one, where the total receipts are the same whatever the number of units sold.* There is no reason why the elasticity of demand for a particular commodity should be the same throughout; the same commodity might have an elastic demand for one range of prices and quantities and an inelastic demand for another.

The difference between elasticity and inelasticity is illustrated in the accompanying table, which is based on the schedule on page 593.

Price	Quantity	Total Receipts
$9	1	$ 9
8	2	16
7	3	21
6	4	24
5	5	25
4	6	24
3	7	21
2	8	16
1	9	9
0	10	0

Graphically this may be illustrated as in Fig. 2.

There are two peculiarities of this diagram which should be pointed out. In the first place, it is ordinarily impossible to plot a total receipts curve (*TR*) and a demand curve (*DD′*) on the same vertical scale because the values represented by the total receipts are so much greater than the price per unit. The two curves can be put on the same scale only when the total quantity is small. Secondly, the vertical scale is to be read in two ways: as total dollars received by selling a given quantity (when using the total receipts curve), and as the price at which each unit in a given quantity will be sold (when using the demand curve).

Here the demand curve, *DD′*, is a straight line. Starting from very small quantities, as the quantity placed on the market increases, the price per unit drops. At the beginning, the price drop is not enough to keep total receipts from increasing. Total receipts increase as more units are sold until a maximum is reached. Up to this point, *N*, therefore, the demand is elastic. Thereafter the total receipts from larger quantities decrease until finally, when the unit price becomes zero (where the *DD′* line cuts the horizontal axis), total receipts also become zero. This straight line demand curve does not have the same elasticity throughout; in fact, it is highly elastic at the beginning and highly inelastic at the end, and is neither elastic nor inelastic at the midpoint, where the total receipts become a maximum. If a monopolist had the quantity *OM* to sell, he would get the most by selling half that quantity and keeping half off the market.

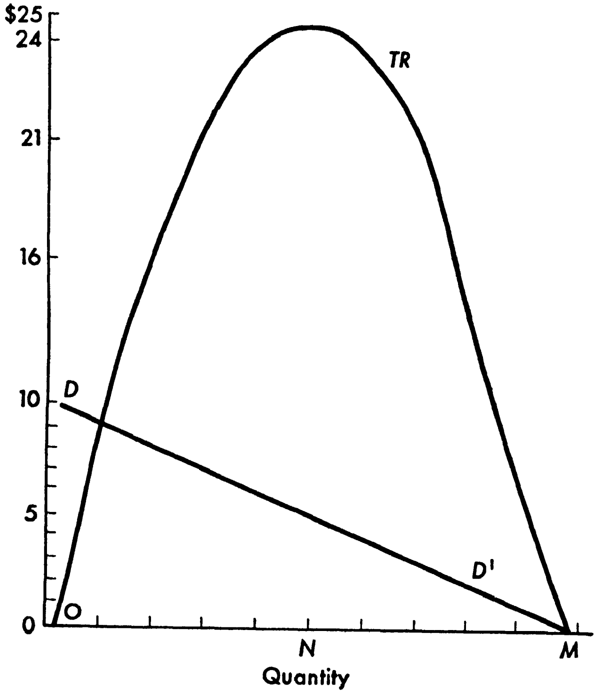

FIGURE 2

The difference between elasticity and inelasticity may be illustrated also in another type of diagram, as in Fig. 3, where the demand curve alone is used and the total receipts are measured by a rectangle, one side of which represents quantity sold and the other side of which represents unit price. The elasticity can be ascertained by comparing the size of the rectangles:

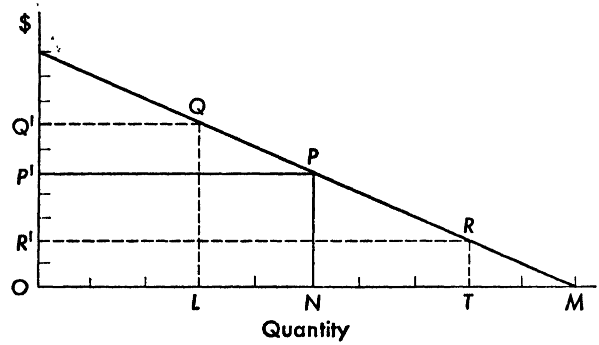

FIGURE 3

The total receipts for the quantity *ON* are *ONPP'*; they are greater than the total receipts *OLQQ'* for the smaller quantity *OL*; the demand is therefore elastic between *OL* and *ON*. The greater quantity *OT* sells for *OTRR'*, a smaller amount than *ONPP'*; the demand is therefore inelastic between *ON* and *OT*.

Another way of stating the definition of elasticity is in terms of increment receipts, a concept very useful in analysis. Increment receipts are the amount of the additions to total receipts.[1] When total receipts increase as quantity increases, demand is elastic and increment receipts are positive. When total receipts decrease as quantity increases, increment receipts are negative and demand is inelastic.

The relationship between total receipts and increment receipts is seen most clearly in diagrams which omit the demand curve. The case of a farmer who

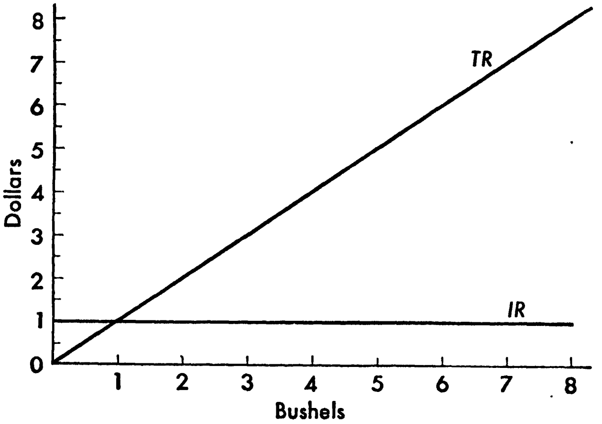

FIGURE 4

can dispose of his entire wheat crop without affecting the market price at all is the extreme case of elasticity. For then, each additional bushel sold adds a constant amount to the total receipts, and total receipts are represented by a straight line rising steadily as each additional bushel is sold. Likewise, since each additional bushel brings no reduction in price, the increment receipts are represented by a straight line, which is parallel to the horizontal axis. This is illustrated in Fig. 4, where it is assumed that the price is $1 per bushel and the farmer has any number from 0 to 8 bushels to sell.

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[1] The term "marginal revenue" is also frequently used to designate this concept.

The idea of increment receipts may be clarified by adding these new figures to the assumed data already given on pages 593 and 594. This demand is elastic from 1 to 5 units, and is inelastic when more than five units are put upon the market. This situation is illustrated diagrammatically in Fig. 5, in which an increment receipts (*IR*) curve is added to the diagram shown in Fig. 1.

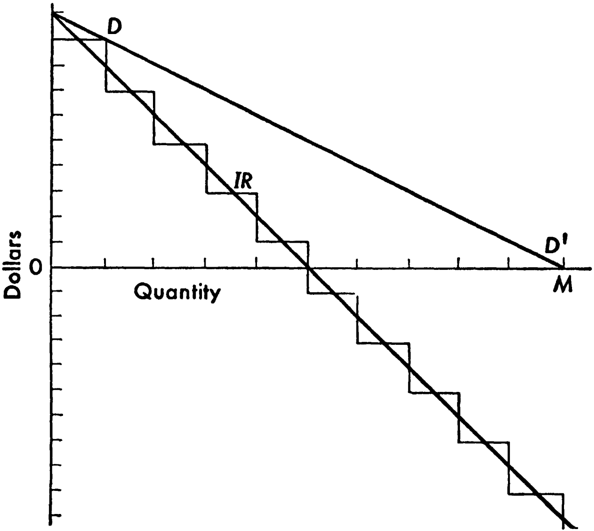

FIGURE 5

Price	Quantity	Total Receipts	Increment Receipts
$9	1	$ 9	
8	2	16	$7
7	3	21	5
6	4	24	3
5	5	25	1
4	6	24	−1
3	7	21	−3
2	8	16	−5
1	9	9	−7
0	10	0	−9

As is shown in this illustration, the increment receipts curve is not really a "curve" but a series of steps representing the successive amounts added to total receipts by the sale of additional units. When large quantities are involved, as is commonly the case (e.g., 900,000,000 bushels of wheat produced in the United States in one year), each step in the series becomes so small that for practical purposes the series of steps becomes a straight line.

The relationship between total receipts and increment receipts is shown in Fig. 6. After the quantity *ON* is put on the market, total receipts decline.

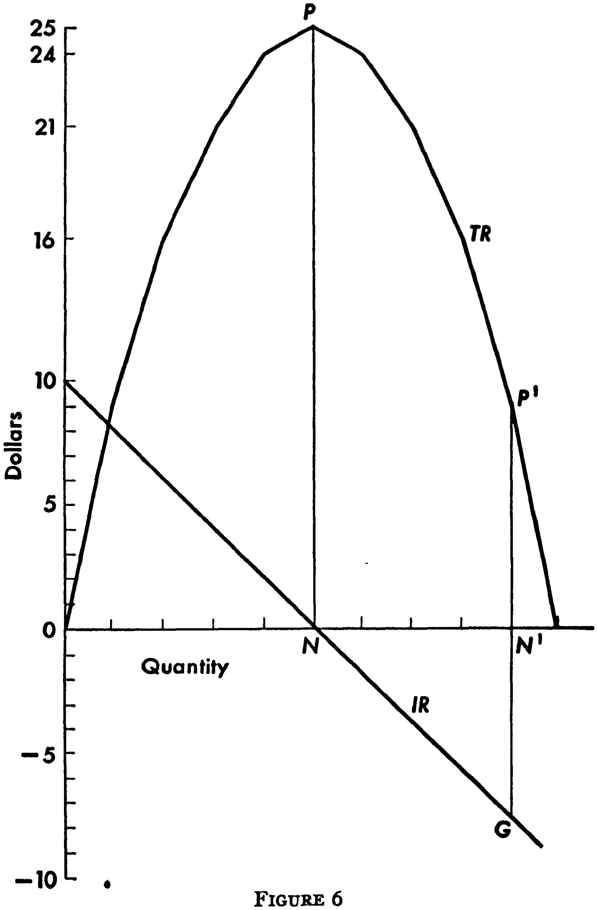

FIGURE 6

From that point on, additional receipts are a minus quantity, and the increment receipts curve *IR* is below the horizontal axis. The loss of total receipts, brought about by putting *ON'* on the market instead of *ON*, is the value of *PN*, as shown on the vertical scale (25), minus the value of *P'N'*; this is likewise the same as the area *NN'G*, which measures the amount of negative additional receipts.

Although increment receipts can be seen most simply in diagrams without the demand curve, when both curves are used the total receipts are shown either by the rectangle under the demand curve (as already illustrated in Fig. 3) or by the irregular area under the increment receipts curve. The distance from the demand curve to the horizontal axis represents the unit price. The distance from the increment receipts curve to the horizontal axis represents the addition to total receipts at that point.

If this last statement is to be accurately illustrated by the diagrams used here, the increment receipts have to be treated as a series of steps, as in Fig. 5. For the usual situation, however, dealing with large numbers, the increment receipts are represented by a line, and the distance from the curve to the horizontal axis at any point represents the addition to total receipts at that point. To illustrate: if the tables we have been using were in hundreds of units, instead of single units, a few selected figures would be as follows:

Price	Quantity	Total Receipts	Increment Receipts
$6.00	400	$2,400.00	
5.99	401	2,401.99	$1.99
5.98	402	2,403.96	1.97
5.51	449	2,473.99	1.03
5.50	450	2,475.00	1.01
5.49	451	2,475.99	0.99
5.01	499	2,499.99	0.03
5.00	500	2,500.00	0.01
4.99	501	2,499.99	—0.01
4.98	502	2,499.96	—0.03

In Fig. 7, the quantity *ON* brings the unit price *PN*; the total receipts are *ONPT*. The total receipts are also represented by *ONF*. Both areas have

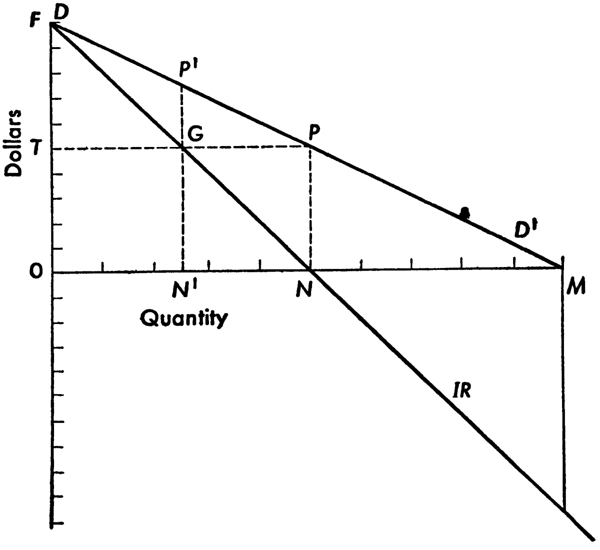

FIGURE 7

ONGT in common, and the area *FTG* is equal to the area *GPN*. At the point *N*, the increment receipts (*IR*) curve touches the horizontal axis. At this point, the total receipts reach their maximum; beyond this there is no addition to total receipts, and demand is no longer elastic. If the quantity *ON′* is put on the market, the unit price is *N′P′*, and the line *GN′* (the line from the increment receipts curve to the horizontal base) shows the amount added to total receipts at the point *N′*. The total receipts are *ON′GF*.

The tables and diagrams thus far have all illustrated a straight line demand curve. This assumption was chosen because it avoids unnecessary complications involved in other types of demand curves; but the principles for others are the same as for a straight line curve. An example of another type of demand curve is given in the following table and illustrated in Fig. 8.

Price	Quantity
$1.00	100
0.95	125
0.90	180
0.85	225
0.80	300
0.75	400
0.70	425

The question may be asked, under what conditions is the demand for a commodity elastic? Under what conditions will a lowering of price lead to a great increase in physical volume? The only general answer possible is that elasticity depends upon the desire for the commodity and upon the substitutes for it. If the desire for a commodity is especially urgent, a higher price will not result in a great decrease in the quantity sold unless there are many substitutes available. If there are many substitutes available, a lower price will result in the commodity's replacing them, and a higher price will result in the commodity's being replaced by them, provided the prices of the substitutes do not change at the same time and to the same extent. The most immediate substitutes for the product of any company are the products of its competitors.

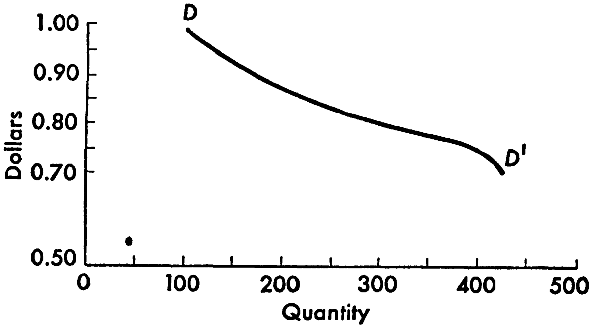

FIGURE 8

It follows that the more highly competitive is the situation of a company, the greater is the elasticity of demand for its product. Another general proposition is that the demand is more elastic over a period than it is at once, because the process of substitution often takes time. Established methods of distribution, established brands, buyers' ignorance and buying habits, and other similar factors slow down the rate at which a cheaper substitute can make inroads on the market of its competitors.

In practice an accurate estimate of the probable response of volume to price changes is extremely difficult. The problem is clearly one of business judgment, not to be solved by any simple formula.[1] Yet the practical difficulties of

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[1] A mathematical procedure for measuring the elasticity of demands is described as follows by Eric James Broster in *Cost, Demand and Net Revenue Analysis* (London, Gee, 1938), pp. 30–34:

"When the price of any article of commerce rises, the demand for it diminishes, and when the price falls, the demand for it increases. If, for a rise in price, the decrease in demand is insufficient to prevent a rise in gross revenue, the demand is not sensitive to price change, and is said to be inelastic. The same remark applies to a fall in price that results in an increase in demand insufficient to prevent a fall in gross revenue. On the other hand, if a rise in price is accompanied by a decrease, or a fall by an increase, in gross revenue, the demand is sensitive to price change and is said to be elastic.

"Suppose that in any month the public demand for a particular brand of soap is 1,000 tablets when the price is 1s. a tablet and 1,500 when the price is 6d. Since the gross revenue yield of the higher price (1,000 at 1s. = £50) is greater than that of the lower price (1,500 at 6d. = £37 10s.) the demand is inelastic. If, however, the demand at 6d. exceeded 2,000 tablets, then the gross revenue yield of the lower price would be the greater, and the demand in that case would be elastic.

"The discovery of this phenomenon led to the formulation of a means of measuring the elasticity of demand—a means that is universally applicable. Its basis is a simple mathematical formula so devised that, if gross revenue remains constant when the price is altered, the resulting value of the elasticity of demand is one, or unity. Where the demand is inelastic the value is less than unity, and where elastic greater than unity.

"I do not propose dealing with the theory of this formula. Such considerations have been fully examined elsewhere. Our purpose is to apply it in practice. Sufficient if I add that it represents the ratio of the price charged to any small change in that price multiplied by the ratio of the resulting change in the quantity sold to the total quantity sold. It may be stated in the form of an equation:

$$n = \frac{p}{p - p'} \cdot \frac{x' - x}{x}$$

$$= -\frac{x - x'}{p - p'} \cdot \frac{p}{x}$$

where n is the measure of the elasticity of demand, p and p' are two prices, and x and x' the corresponding quantities. Reducing $p - p'$ indefinitely, we have

$$n = -\frac{pdx}{xdp} \qquad (1)$$

which is the analytical form of the elasticity of demand.

"There are *a priori* grounds for supposing that the elasticity of demand tends to vary directly as the price—that it is higher for high prices than for low prices. However, as I have shown elsewhere, there are equally sound *a posteriori* reasons for supposing that this sensitiveness of the elasticity of demand to changes in prices is imperceptible when the price range is limited to what we generally find to be the case in the real world, even over a considerable period of years. As Marshall shows, the general equation to demand curves at every point of which the elasticity of demand is the same is:

$$xp^n = k \qquad (2)$$

in which x, p, and n have the meanings ascribed to them above, and k is a constant. This judging elasticity must not lead to dismissing the problem as arbitrary guesswork, for much of the success of an enterprise depends upon sound business judgment in this area. In fact, the decision on elasticity is usually easiest when the problem is of little importance, and hardest when most depends upon it.

. . . .

DERIVED DEMAND

Strictly speaking, the demand for all goods except finished consumers' goods, such as shoes and cigarettes, is derived from the demand for finished consumers' goods. But the term is usually limited to the cases where the connection between the goods is important. For example, the demand for some

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equation forms the basis of the law of demand for any commodity within the range of prices normally to be observed during any period of a few years.

"Returning to the simple example of the soap tablets, we may easily be led to the erroneous conclusion that because the demand is 1,500 per month when the price is 6d., and 1,000 per month when the price is 1s., the demand would be at the rate of 1,250 when the price is 9d. The problem is not one in ratio and proportion. From equation (2), we have its linear form:

$$\log x + n \log p = \log k$$

Substitute the known values of x and p

$$\log 1000 + n \log 12 = \log k$$

and

$$\log 1500 + n \log 6 = \log k$$

$$\therefore \log 1000 + n \log 12 = \log 1500 + n \log 6$$

$$\therefore \log 1500 - \log 1000 = n(\log 12 - \log 6)$$

and

$$n = \frac{\log 1500 - \log 1000}{\log 12 - \log 6}$$

$$= \frac{3.1761 - 3.000}{1.0792 - .7782}$$

$$= .585$$

which is the measure of the elasticity of demand for the tablets. Now solve for k by substituting this value for n in either of the equations with which we began:

$$\log k = \log 1000 + .585 \log 12$$

$$= 3.000 + .585 \times 1.0792$$

$$= 3.6313$$

$$\therefore k = 4279.$$

The complete equation for our hypothetical soap tablets is therefore

$$xp^{.585} = 4279$$

To determine the quantity that would be sold in a month if the price were 9d. per tablet, substitute 9 for p:

$$x \times 9^{.585} = 4279$$

$$\therefore \log x = 3.6313 - .585 \times .9542$$

$$= 3.0731$$

$$\therefore x = 1183.$$

The quantity that would be sold in a month if the price were 9d. a tablet is therefore not 1,250 as at first may be supposed, but 1,183. Such an equation should give reasonably accurate re-leathers is derived from the demand for shoes; but the demand for lubricants for machinery is so little dependent upon the demand for shoes, even though some lubricants are used in the shoe industry, that it is not treated as derived.

The well-known discrepancies between fluctuations of wholesale and retail prices show that it is important to consider the time factor. The demand for raw materials is not based upon the current demand for the finished product, but upon the changes in the demand anticipated in the future. The demand for tomatoes for canning is dependent upon the outlook for the ensuing year. Where the production period is long and where the storage possibilities are great, the connection between the consumers' demand and its derived demands may be much obscured.

The time factor is particularly important in the case of capital goods. The demand for capital goods is dependent upon the demand for the finished goods throughout the life of the machinery. The demand for machinery thus changes with the sums available for investment and the investors' expectations of the future. Minor fluctuations in demand for the finished products are taken up in the rate of the operation of the machinery already in existence, and the derived demand for machinery is not affected.

A steady demand for new installations of capital goods (excluding replacements) is dependent upon a steady increase in the demand for the finished product. If an industry which has been growing steadily should become stable, the reduction of its demand for machinery to a simple replacement basis represents a drastic curtailment. The capital goods case of derived demand is another instance of the importance of the time factor, and appears wherever there is a marked difference in the life of the machinery and the life of the finished product. Although the demand for raw materials and the demand for machinery are both derived from the demand for the finished product, they respond very differently to increases or decreases in that demand.

Another important case of a derived demand is the relationship among several commodities combined in one product. Here the demand for one of the constituents is dependent not only upon the demand for the finished product but upon the supply of the other constituents. For example, an abundant supply of gasoline available at low prices strengthens the demand for automobile tires. Where there are many constituents, the elasticity of the demand for any one of them may be radically different from the elasticity of the demand for the

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sults where the highest price is not more than double the lowest price. It would not be safe to use the same complete equation for the hypothetical soap tablets for the purpose of determining the number that would be sold if the price were raised to 2s., for instance, or reduced to 3d.

"When the values of n and k have been determined, we can therefore ascertain—*other things being equal*—the quantity that will be sold for any given price:

$$x = kp^{-n} \tag{3}$$

or the price that will lead to the sale of a given quantity:

$$p = \left(\frac{k}{x}\right)^{\frac{1}{n}} \tag{4}$$

Equations (2), (3) and (4) represent in different forms what has come to be known as the *static* law of demand. They do not take into account those 'other things' that may not be equal. . . ."

final product. A drop of 50% in the price of one, and only one, constituent might change the price of the finished product by 1% and, even if the demand for the finished product was highly elastic, lead to only a small increase in the quantity sold.

These relationships between the demand for consumers' goods and the demands derived from it are important in the study of the so-called failure of demand and supply to maintain economic balance and stability.

SOME NOTES ON THE CONCEPT OF COST IN ECONOMICS

The term "cost" is likely on occasion to be used in different senses by the economist, the accountant, and the businessman. Care must be exercised to prevent errors which might be caused by a misunderstanding of the meaning of the word "cost" and other words used by economists, by accountants, and by businessmen to describe various kinds of costs.

Financial accounting has a specific task, namely, the analysis of the operations and status of a business in a period that is closed. Its main concern is with ownership (balance sheet) and with the origin and disposition of funds (operating statement). For these purposes, accounting uses more or less exact and unchanging definitions and categories. No profit and loss statement would be complete, for example, if it did not recognize depreciation as a cost. Accountants recognize as a cost interest paid out on borrowed funds, but not imputed interest on owned capital. They recognized salaries or regular commissions paid to the executives of a business, but not compensation in other forms. In general, the accountants follow well-defined rules for the division between items called costs and the other items. They seek to put each item in its appropriate place at all times. They are, in general, opposed to considering an item as a cost under some circumstances and not under others. The economists' distinction between cost and other items, however, varies with the period and the problems under consideration; economists say, for example, that selling expense may be an economic cost under some circumstances but not under others.

Business executives not infrequently wish to make use of figures for purposes different from the strict purposes of financial accounting. They wish to determine, for instance, the most profitable rate of operation of a given plant or department; they desire to know what price to quote to a prospective customer; they need to know whether to accept a particular order; they want to know whether it will be profitable to buy a new machine; and so on. So far as these calculations are related to costs, the businessman is interested in the costs which *will be incurred*, those which lie ahead, those which are contingent on the particular proposal being considered; not those which have already been incurred, those to which the business is already committed. If it is a question whether

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Source: Malcolm P. McNair and Richard S. Meriam, *Problems in Business Economics* (New York, McGraw-Hill, 1941), pp. 166–175.

to increase production by using a machine now idle, the costs of materials to be purchased and of direct labor to be hired obviously are factors in the calculation; but depreciation on the machine clearly is not a factor, and neither is the wage of a foreman who will continue to be employed in any event, whether the machine is operated or not. This distinction between the expenses which *have been incurred* and the expenses which *are to be incurred* is important to the reasoning of the business executive who is trying to determine a policy.

It is essential to recognize that the time span of the proposal under consideration has a significant bearing on the costs which the business executive needs to calculate. If it is a question of increasing output over a short period, probably the supervisory staff will not have to be augmented. But if the period for which the expansion is contemplated is a longer one, then an additional foreman may be needed. Similarly, so long as the contemplated expansion can be handled by the existing plant, the fixed expenses connected with the plant are not a consideration. But if the proposal is one which involves building a new plant, then all the fixed costs connected with that plant must be taken into account, not merely all the items which good accounting practice would recognize, but also such other costs as the return on capital. The businessman in this situation is concerned with the problem of what will constitute the most remunerative use of his capital. The list of costs which the business executive needs to consider, therefore, may be either shorter or longer than the customary list of items included in accounting costs. The accompanying tabular view contrasts the list of costs which might be appropriate to a short-period problem with those appropriate to a long-period problem and compares both with the accepted costs in the accounting sense:

Short-Period Business Costs	Accounting Costs	Long-Period Business Costs
Direct labor	Direct labor	Direct labor
	Indirect labor	Indirect labor
	Wages of management—actual	Wages of management—actual
		Wages of management—imputed
Materials	Materials	Materials
Spoilage	Spoilage	Spoilage
	Selling expense	Selling expense
	Rent—actual	Rent—actual
		Rent—imputed
Taxes—variable (e.g., on income)	Taxes—variable	Taxes—variable
	Taxes—fixed (e.g., on real estate)	Taxes—fixed
	Insurance	Insurance
	Depreciation	Depreciation
Interest—on funds actually used	Interest—only actually paid	Interest—actually paid
		Return on owner's capital

The foregoing contrast is typically valid and useful, but there will be some exceptions in particular cases which can readily be discerned by those familiar with the reasons for the classification. For instance, selling expense may be a short-period cost in a case where salesmen are paid by commission or where it is necessary to employ an additional salesman.

In considering problems, the businessman, of course, makes use of figures obtained from his accounting department; but because of the differences in point of view just described, he may wish to revise the accounting figures for his purposes. In some companies—indeed in a growing number—the accounting department itself may be concerned with the preparation and analysis of figures to aid executives in reaching decisions. For example, the purpose of the so-called flexible budget is specifically to furnish the types of figures required by business executives for use in planning operations; but the procedures used in this type of accounting work are to be distinguished from those which are characteristic of general financial accounting.

The economist's point of view on costs is close to the essential distinctions which the business executive must make, although these distinctions are not always expressed in the same language. In economics, the essential idea is that cost is a resistance point, that if price is below cost the quantity produced will be curtailed. Any payment to a factor of production which has to be paid the market rate to keep it at work producing the particular commodity—a factor which will resist, by moving to other opportunities for employment, the downward pressure of a decline in the demand for the commodity—is an item of cost. If it is a question whether or not to operate an existing factory during a given season, depreciation, rent, insurance, taxes, and other expenses—expenses which have already been incurred or which will be incurred regardless of the decisions on the question—are not resistance points. But if it is a question of building a new factory, all these expenses are resistance points. These are not the only ones; for the return on owner's investment must also be included as a resistance point. All these are forces which resist the putting to work of these particular factors of production. Another way of saying this same thing is that the price of the product has to be sufficiently high to induce labor, landowners, investors, technicians, and businessmen to forego other opportunities and to build and operate the factory. The entrance of these factors into the production of a commodity or their departure from it is often a long-drawn-out affair. It takes longer the more durable is the product and the more durable, expensive, complicated, and specialized are the human and material factors used in its production.

In the short period, some of the factors which would vary in a longer period are tied to the business and are inescapable if the business continues as a going concern. The most important of these are the specialized plant and equipment, the so-called "fixed," costs. These costs, which do not vary in the aggregate as the equipment is worked at a lower or higher rate—which go on, whatever the output of the plant—must be distinguished from the others by the businessman; for the short period, the economist does not call them costs, although the accountant does. They represent factors which cannot be moved out of the way of a decline in demand and which, therefore, do not offer resistance to the decline in price caused by the decline in demand. The statement that manufacturers will temporarily sell "below cost" to cut their losses refers to costs in this category and is equivalent to the statement that these "costs" are not immediate resistance points to the fall in price.

If we leave out of account the important effect on present behavior of anticipating the future, we may safely say that the businessman tries to get the maximum difference between total receipts and total outlays. In setting his price and determining his output, he wants to know how his receipts and outlays will vary with the price charged or with the quantity put on the market. The so-called "fixed" costs, which do not vary with his price or rate of output, do not affect, or should not affect, his calculations.

Thus, in the thinking both of the businessman and of the economist there is a distinction to be made between these two classes: those items which are costs for the period, or in relation to the project contemplated, and those which are not. A great variety of terms with various shades of meaning is in use to designate these two categories; note, for instance, the following:

Fixed	Variable
Indirect	Direct
Overhead	Operating
Inescapable	Escapable
Sunk	Current
Existing	New
Book	Out-of-pocket
Long-run	Short-run
General	Special
Supplementary	Prime

Most of these terms make some distinction between a short and a long period in which or for which the outlays are incurred. Among these terms, there are several which are sometimes distinguished from one another and sometimes used interchangeably. In practical usage, some of these terms are employed interchangeably even though an exact interpretation of their meaning would not sanction this habit. For instance, the term "out-of-pocket costs" is sometimes loosely used to mean the expenditures which will be incurred in a period if a particular program is followed, whereas it means, strictly, payments to outsiders as contrasted with, say, depreciation, which is not a current cash expenditure to an outsider. Out-of-pocket costs and variable expenses are not identical classes; real estate taxes, for instance, are out-of-pocket costs which have to be paid anyway and do not vary with the rate of operation.

The terms commonly used by the economist to designate these two general categories of costs are "fixed" and "variable." Strictly speaking, the "fixed costs" are not, to the economist, costs at all for the short period; they are not necessary payments to keep production going; and if the economist speaks of short-period costs, the fixed costs are excluded and the variable costs are included. The term "variable" refers to those costs which vary *in total* as volume changes, whereas the term "fixed" is used to designate those costs which will remain unchanged *in total* for the period, irrespective of the volume of production or sales. It is to be noted that costs which are variable *in total* may be more or less fixed per unit of output, and conversely that costs which are fixed *in total* irrespective of output will naturally vary per unit of output. The proper use of these two terms is in the *total* sense.

Accurately speaking, variable costs are those which vary in total strictly in proportion to output; they may be called "proportionate costs." In actual practice, however, the term "variable costs" is employed to describe costs that vary with output if the variation is not far from strict proportionality. Sometimes businessmen make a third category, of semivariable expenses. But for business calculations looking into an uncertain future, the rough distinction between "variable" or "proportionate," on the one hand, and "fixed," on the other, is accurate enough for most practical purposes.

It is important to recognize that for the businessman and the economist "fixed" and "variable" costs are not unchanging categories always containing the same items. Rather they are labels for the period involved. For a short period, wages of supervisory labor are likely to constitute a fixed cost; for a considerably longer period, these wages may well be a variable cost. The distinction between the two periods, long and short, is, of course, merely a helpful oversimplification; between the two extremes there are periods of various lengths; what is cost for the particular period and for the particular problem must be determined in each case by reference to the outlays necessary to keep productive factors at work. The longer the period, the longer the list of costs which are variable, and vice versa. The accountant, on the other hand, is more likely to use such terms as "variable" and "fixed," "direct" and "indirect," or "overhead" and "operating" to designate unchanging categories always containing substantially the same items.

Figure 1 presents the problem for a short-run period, say, one year. Line *A* represents the total receipts; *B* the "total costs," in the financial accounting

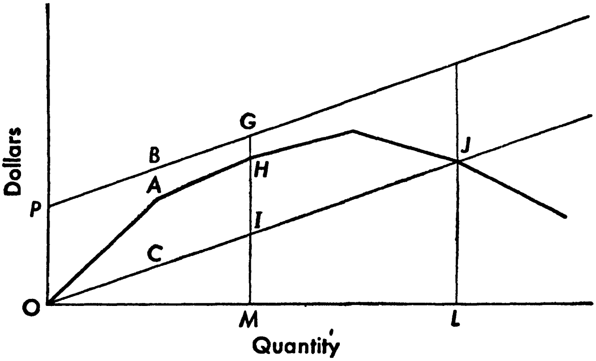

FIGURE 1

sense, including the fixed costs which will not vary at any volume of operation within the range considered; and *C* the costs for the short run, in the economic sense, excluding the fixed costs in order to arrive at the resistance point at which operations should cease. These costs, according to the economists' concept, are the "variable costs." At no rate of operation can this business make a "profit" in the sense of having total receipts cover both fixed costs *PO* and variable expenses. The best thing for this business is to produce the quantity *OM* and sustain the minimum loss *GH*. This fact can be seen more clearly if we ignore fixed costs entirely. At the rate of output *OM*, the company gets the biggest difference *HI* between economic costs *IM* and total receipts *HM*. The company would never produce more than *OL*, because at that point the total receipts just equal the economic costs *JL*. It is to be noted that this is a case where, by assumption, the market price is affected by the rate of operation of this particular business concern.

The above illustration is artificially simplified by the use of straight lines to represent costs. The straight lines imply that the total variable costs vary in strict proportion to output. This is the assumption that the additional expenditure necessary to produce each additional unit is constant. Figure 2, based on the table shown on page 610, abandons these simplifying assumptions.

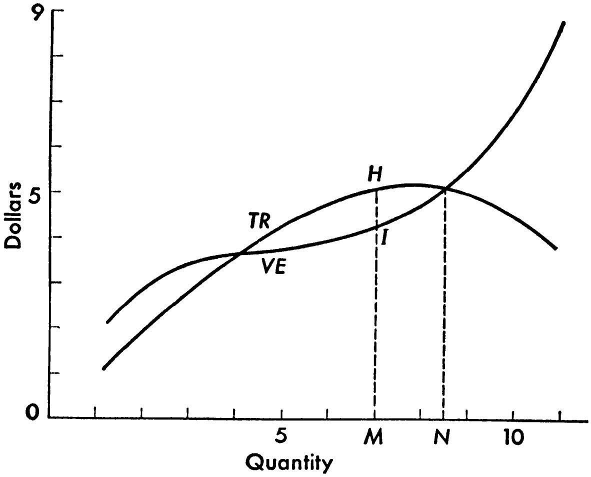

FIGURE 2

Here the additional expenses of producing larger quantities are not constant per unit; they are first reduced as the company frees itself from the inefficiencies of abnormally small rates of operation, and later they advance as the company encounters the inefficiencies of abnormally high rates of operation. If the company operated at the high rate *ON*, there would be nothing left of the total receipts after the variable expenses. The most advantageous rate of operation is *OM*, where total receipts exceed variable expenses by the maximum amount *HI*. This is the point where the company obtains the largest "operating contribution," that is, where it cuts its losses to the minimum. The largest operating contribution is the greatest contribution to fixed costs and to profits. If the company is having profitable operations, at this point its profits are at their maximum; if losses, the losses are at their minimum.

A	*B*	*C* $(A \times B)$	*D*	*E* $(D \div B)$	*F*	*G* $(D + F)$	*H* $(G - C)$
Price	Number of Units Sold	Total Receipts	Total Variable Expenses	Average Variable Expense per Unit *	Total Fixed Expense	Total Expense	Loss
$1.00	1	$1.00	$1.82	$1.82	$2.00	$ 3.82	$2.82
0.98	2	1.96	2.92	1.46	2.00	4.92	2.96
0.95	3	2.85	3.42	1.14	2.00	5.42	2.57
0.91	4	3.64	3.68	0.92	2.00	5.68	2.04
0.86	5	4.30	3.80	0.76	2.00	5.80	1.50
0.80	6	4.80	3.96	0.66	2.00	5.96	1.16
0.73	7	5.11	4.27	0.61	2.00	6.27	1.16
0.65	8	5.20	4.80	0.60	2.00	6.80	1.60
0.56	9	5.04	5.67	0.63	2.00	7.67	2.63
0.46	10	4.60	7.10	0.71	2.00	9.10	4.50
0.35	11	3.85	9.02	0.82	2.00	11.02	7.17

* Short-period economic cost.

It should be noted that the most advantageous rate of operation, the rate which gives the largest operating contribution, is at the point where the *TR* and *VE* lines are parallel, where both expenses and receipts are growing at the same rate. This may be restated as follows: the point of most advantageous operation is that at which the addition to total receipts, i.e., the increment receipts, is equal to the addition to expenses, i.e., the increment expenses.[1] Up to the point of maximum operating contribution, expansion of output brings

B	*I*	*J*
Number of Units Sold	Increment Receipts	Increment Expenses
1	$1.00	$1.82
2	0.96	1.10
3	0.89	0.50
4	0.79	0.26
5	0.66	0.12
6	0.50	0.16
7	0.31	0.31
8	0.09	0.53
9	−0.16	0.87
10	−0.44	1.43
11	−0.75	1.92

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[1] "Increment expenses" may also be described by the term "marginal costs." Both these terms designate the amount of the increase in the total variable costs.

increment receipts greater than increment expenses; the contribution is growing. Beyond that point, further expansion brings increment receipts smaller than increment expenses; the contribution is diminishing. At the precise point of the maximum operating contribution, the last unit adds nothing. The production of the last unit is a matter of chance, and to the businessman a matter of indifference. In Fig. 2, the last unit of the *OM* units adds nothing to the operating contribution, which remains at 84 cents.

This situation may be illustrated by adding the increment receipts and increment expenses to the table already given, or by plotting the increment receipts curve and the increment expenses curve as shown in Fig. 3.

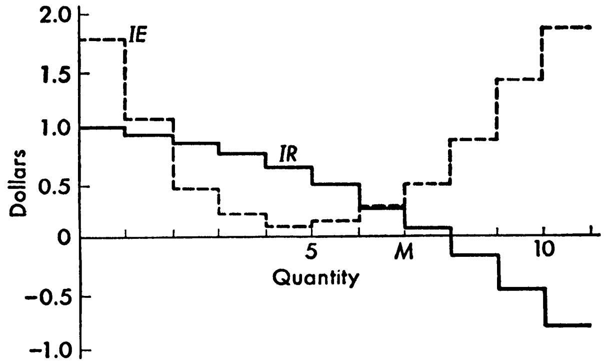

Figure 3

Here again, the most advantageous rate of operation is *OM*. Up to this point, the increment receipts (*IR*) curve lies above the increment expenses (*IE*) curve; more is being added to receipts than to expenses. Beyond this point, the opposite is true. This rate of operation contributes the most to the fixed "costs" and profits of the business; it is the rate of operation which maximizes the operating contribution.

It is to be borne in mind that whereas the foregoing discussion is concerned with the variation of costs in relation to output, there are, of course, factors other than changes in output which may cause costs to vary; for instance, changes in the general price level, cyclical changes in business, taxes, inventions, improvements, and so on, all may change cost, expressed in dollars and cents, for the same output. In dealing with practical problems, consideration must be given to all these causes of changes in costs, as well as to those cost variations which are strictly related to the level of output.

Accounting typically treats cost from the point of view of the individual business, whereas the economists talk sometimes of the individual business, sometimes of a whole industry, and sometimes of all the businesses of a country taken together. Some economists when dealing with the entire economic life of a country prefer to treat the natural resources as a given supply and the price paid for their use, i.e., rent, as no part of cost, because the price paid does not affect the supply of land available. For purposes of business economics, which deals more with the problems of an individual company or industry, the exclusion of rent from cost is unnecessary and awkward, because the natural resources available for a company or industry are not fixed, and a price, rent, has to be paid to keep them from other businesses.

SOME NOTES ON ACCOUNTING FOR MANUFACTURING COSTS

BY CECIL L. BURRILL

These notes have a dual purpose: (1) to outline the procedures involved in the periodic determination of actual unit manufacturing costs and (2) to differentiate actual and standard unit costs.

NEED FOR DETERMINING UNIT MANUFACTURING COSTS

Periodic determination of unit manufacturing costs is necessary in order to value inventories of goods in process and inventories of finished goods for balance sheet and income statement purposes. Neither the cost of goods manufactured nor the cost of goods sold during a period can be ascertained unless unit manufacturing costs are known; the cost of goods manufactured is affected by the values of beginning and ending inventories of partially manufactured products, and the cost of goods sold is affected by these figures and by the values of beginning and ending inventories of completed products as well. Unit manufacturing costs may under some circumstances be useful also in the calculation of selling prices. Finally, when several products are manufactured, unit costs are of some help in determining the relative profitability of the various items and lines.

PROCEDURES INVOLVED IN DETERMINATION OF ACTUAL UNIT MANUFACTURING COSTS

Manufacturing costs are divided into three main groups: (1) material, (2) direct labor, and (3) overhead costs or burden. Material costs are the costs of materials which are incorporated in the final product; they do not include supplies or fuel. Direct labor costs consist of the payroll for employees engaged in the actual fabrication of the product. Manufacturing overhead costs, or burden, include all other manufacturing expenses, such as indirect labor, supervision, maintenance, supplies, insurance, taxes, depreciation, light, heat, and power.

When more than one product is manufactured, the determination of unit manufacturing costs involves the accumulation of costs by manufacturing de-

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Source: Malcolm P. McNair and Richard S. Meriam, *Problems in Business Economics* (New York, McGraw-Hill, Inc., 1941), pp. 160–166.

partments, either because all products do not pass through all departments or because the relative cost incurred for each product varies among departments. The total cost applicable to each manufacturing department cannot be determined directly, however, because not all manufacturing costs are incurred directly by manufacturing departments. Some departments of a business function as service units for the operating departments. The costs incurred by a service department ordinarily are not made up entirely of costs chargeable directly to manufacturing but include some selling and administrative costs as well. An example is afforded by a maintenance department responsible for maintaining the physical property of the business. To the extent that the maintenance is performed on manufacturing plant, the costs incurred are manufacturing costs. Some maintenance costs are incurred, however, in maintaining sales and administrative offices and equipment. These latter costs must be separated from the other maintenance costs, which are divided among the several manufacturing departments.

In general, to obtain manufacturing costs per unit of product, it is necessary to go through the following steps, in the order given:

1. Determine the costs incurred in each department of the business without regard to the function of the department.
2. For each service department, determine the costs which are applicable to manufacturing and allocate them to the manufacturing departments for which they were incurred.
3. After steps 1 and 2 have been completed, allocate the costs of each manufacturing department to the products manufactured in the department.
4. To obtain the total manufacturing costs of a particular product, add the costs for that product incurred in the several manufacturing departments.
5. To obtain the unit cost, divide the total (step 4) by the number of units produced.

If costs are to be accumulated by departments, it is necessary that records be kept of the material consumed and the direct labor and overhead costs incurred in each department. Departmental figures for material and direct labor costs can be determined directly since material requisitions can be prepared to show the value of materials entering each department, and a variety of labor records can be designed to show the labor cost incurred. The direct determination of the amount of overhead incurred in each department, however, is not always possible. While some overhead costs of a department—such as indirect labor; depreciation, insurance, and taxes on machinery and equipment; supplies; and possibly power—can be determined directly, many overhead items are incurred jointly for several departments and must be divided among them on some reasonable basis. For example, several departments may be located in one building. The depreciation expense of the building is an expense of all departments using the building and must be divided among them. A common procedure in this case is to allocate the total depreciation of the building to the departments according to the proportions of the building used by the several departments, perhaps according to the floor space used. Taxes and insurance on the building may be divided in the same way. Similarly, the salary of the plant superintendent is a manufacturing expense and must also be allocated to the departments concerned.

When a service department incurs expense for the manufacturing departments, a way must be found of dividing the expense among these departments. Some of the costs can be charged directly; others must be allocated. If maintenance laborers enter a manufacturing department to repair a machine, records can be kept to show the amount of labor, supplies, and parts used, and these items can be charged directly to the department concerned. But the salaries of the maintenance superintendent and his clerks, as well as the time of the laborers not directly chargeable to the particular manufacturing department, must be allocated. The allocation frequently is made in ratio to the direct charges for maintenance to the particular manufacturing department.

At this point, direct labor, material, and overhead costs of each manufacturing department are known; and if the total manufacturing cost is desired, it can be obtained by adding together the costs of the several manufacturing departments.

The next step in the determination of unit manufacturing costs is to divide the total cost applicable to each manufacturing department among the several products passing through the department. Material and labor costs incurred for each product may be ascertained from records designed to furnish this information. The determination of these costs is comparatively simple, although the bookkeeping required may be expensive when the number of products involved is great. Overhead costs, on the other hand, are more difficult to allocate to products than to allocate to departments. It is usually impracticable to try to charge even the measurable overhead items directly to the various products manufactured. For example, although a meter may be installed to measure the electric power consumed in a particular department, it may not be worth the expense involved to try to measure the power consumed in manufacturing each product within the department. Also, while the total indirect labor in a department can be determined easily, it is impossible in most instances to determine directly how much of the total indirect labor was incurred in manufacturing each product.

For these reasons, approximate methods are used for determining the departmental overhead costs applicable to each manufactured product, and such methods are acceptable provided they give reasonable distributions of total overhead costs among the various products. In choosing a basis of allocating overhead to products, it is helpful to divide departmental overhead into two groups, as follows:

1. Expenses, such as depreciation, insurance, and taxes, which are fixed in amount for a specific period of time. These expenses vary directly with the passage of time.
2. The remaining overhead expenses, including indirect labor, supplies, maintenance, supervision, and power, which are not fixed but vary with the volume of production.

A satisfactory basis for allocating the first group of expenses is one which provides an accurate measure of the time spent in manufacturing the various products. Two common measures are "direct labor hours" and "machine hours," the first being used in departments where operations are manual and the second where the processes consist chiefly of machine operations.

For the second group of expenses, the basis of allocation must provide an accurate distribution of the total departmental volume among the several products. A unit which satisfactorily accomplishes this is not simple to find. Physical output is usually an unsatisfactory measure of volume because some products take more time to produce than others and therefore occasion more overhead. Merely counting the number of units of each product manufactured and dividing overhead in the proportions so derived would give equal weight to each unit of product manufactured. The best unit of volume is the one which measures most accurately the extent to which the facilities of the department are used in manufacturing the product. Therefore it should be closely related to the nature of the manufacturing process.

If operations are manual, as in a department where valve parts are assembled into finished valves, a satisfactory unit is direct labor hours. When this unit is used, it is assumed that proportionately more indirect labor, supervision, maintenance, and so forth, are consumed in manufacturing a product requiring 20 direct labor hours than one requiring only 10 direct labor hours. Obviously this is an approximation. The assumption may not apply equally well to all overhead items, nor to the same overhead items at all times. Two products may consume equal quantities of direct labor, but use different quantities of indirect labor. More supervision may be required in manufacturing a new product than an old one. In a department utilizing machine processes, it is ordinarily desirable to use machine hours as a measure of volume because much of the overhead is incurred in running the machines.

From the foregoing discussion, it appears that the best results can be obtained in allocating departmental overhead to products when a time unit is used as the basis of allocation. The time unit is satisfactory for the fixed expenses which vary with the passage of time; and it provides a reasonable distribution of the total departmental volume, which is needed to allocate the remaining overhead expenses.

For a given company, an analysis of manufacturing operations may lead to the conclusion that in some departments machine hours should be used as a basis of allocating overhead expense and that in others direct labor hours should logically be employed. In practice, however, overhead frequently is allocated on a single basis in order to obtain the advantage of uniformity among manufacturing departments. Perhaps the most common unit used by businessmen is "direct labor dollars," because information concerning direct labor is more easily and quickly obtained when expressed in dollars than when expressed in hours. Direct labor dollars may not be so accurate a measure of volume as direct labor hours, because the direct labor used in manufacturing some products may be more expensive than that used in manufacturing others; yet it must be recognized that, whatever the basis of allocation, only approximately correct results will be obtained.

STANDARD COSTS

The foregoing discussion outlines the steps in ascertaining the actual manufacturing costs incurred during a particular period in each department and for each product. The determination of such costs involves laborious allocations of overhead expenses to departments and to products. This is particularly true of allocations to products. Therefore, unless the management is convinced that the usefulness of actual product costs is commensurate with the expense involved in obtaining them, such costs will not be determined. Let us examine the usefulness to management of actual product costs.

When product costs are expressed on a unit basis (e.g., so much per article or per ton), the cost varies inversely with the volume manufactured; that is, as volume increases, unit costs decline. The explanation of this relationship, of course, is that while the unit cost of direct labor and material remains constant as volume increases (except for changes in efficiency and in prices) the unit cost of overhead does not. Some items of overhead are fixed, at least in the short run. Depreciation, insurance, and taxes typically are in fixed dollar amounts. Therefore, when more units are manufactured, the fixed expenses are spread over a larger number of units and are lower per unit.

In view of their wide fluctuations, how useful are actual unit costs to the management? During periods of very low volume, unit costs may well exceed selling prices. Under such circumstances, should the inventory values given on the balance sheet reflect these high unit costs? In general, accountants answer this question in the negative, since in their opinion the current assets should not be shown at values exceeding the market value even though cost is greater than selling price. When volume is high, on the other hand, unit costs are lower than would be experienced during periods of normal activity. Thus, the use of actual unit costs as the basis for valuing inventories reported to stockholders and creditors through the financial statements is considered to be unsatisfactory.

Nor are actual unit costs very satisfactory from the standpoint of control, since changes in unit costs may be accounted for by changes in volume of production as well as by variations in prices and in efficiency of operation. It is no reflection upon the ability of a department head if his unit costs rise from one period to the next merely because in the latter period the fixed overhead was spread over a smaller number of units. It would be better, therefore, both for control purposes and for purposes of financial statements if the effect of changes in volume upon unit overhead costs could be segregated.

The use of standard costs is a step in this direction. Standard costs may be defined as normal, or average, unit costs. They are determined by averaging the unit costs incurred under the various conditions of volume encountered over the period of a business cycle.

It is possible to establish standard costs for material, for direct labor, and for overhead. Since unit costs of direct labor and materials do not vary much with volume, however, most manufacturers using standard costs apply them only to overhead. When standard overhead costs are used, each unit of a particular product passing through a department is charged with the standard amount or percentage of overhead for that product and that department. Often the standard overhead is a fixed percentage of the direct labor cost, representing the average relationship existing between overhead and direct labor in the department. When this basis is employed, the standard overhead cost per unit for a particular product varies in amount if the direct labor cost per unit varies. Fluctuations are small, however, because unit direct labor costs do not vary widely.

During any accounting period, it is to be expected that the standard unit costs will differ from the actual unit costs. Such differences serve a useful purpose, however, since they indicate that some analysis needs to be made of the causes, whether they be the result of volume changes, changes in prices, or variations in efficiency of operations. When volume is at a high level, the standard overhead costs exceed the actual overhead costs; and when volume is at a low level, the reverse is true. When standard overhead costs are greater than actual costs, overhead is said to be "overabsorbed" to the extent of the difference. Conversely, when actual costs exceed standard costs, the difference is referred to as "underabsorbed" overhead. Over the period of a business cycle, theoretically the underabsorbed overhead should be equal to the overabsorbed overhead since the standard is set at the average to be expected over that period.

Several methods of reporting the differences between actual and standard costs are suggested by accountants. In general, there is agreement that such differences should be included at least once a year in the annual income statement; but there is little agreement as to the point at which they should be inserted in that statement.

THE COST ELEMENT IN PRICING

BY C. B. NICKERSON

The pressure of new problems arising under constantly changing conditions reduces the time available to the businessman for the consideration of perennial problems. The latter type, though less pressing, has a vital bearing on the long-run success of an enterprise and merits periodic review. It was with this in mind that the present consideration of the relationship of costs and selling prices was written.

Questions concerning this relationship constitute a perennial problem of varying intensity. At intervals throughout business history the problem has become acute for a large part of the business community, as it was, for example, under the National Recovery Act, and as it is under the Robinson-Patman Act. For the individual enterprise the problem has varied in importance under changing business conditions, including both short-run and long-run

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Source: *Harvard Business Review*, Vol. XVIII, No. 4 (Summer, 1940), pp. 417–428. Reprinted by permission.

shifts in demand and supply, the introduction of new products, the use of new materials and methods of production, and the increase or decrease in costs of operation, including distribution costs.

Going well back to an earlier day we find Adam Smith speaking of the "natural price" of a commodity, which, briefly, is a price that is neither more nor less than sufficient to cover "ordinary or average rates" of "wages, profit, and rent, at the time and place in which they commonly prevail."

He recognized that the actual price at which a commodity would be sold, called the market price, might "either be above, or below, or exactly the same with its natural price." He said, "The market price of every particular commodity is regulated by the proportion between the quantity which is actually brought to market, and the demand of those who are willing to pay the natural price of the commodity, or the whole value of the rent, labour, and profit, which must be paid to bring it thither."

Referring again to his "natural price," he stated, "Though the [natural] price . . . is not always the lowest at which a dealer may sometimes sell his goods, it is the lowest at which he is likely to sell them for any considerable length of time; at least where there is perfect liberty, or where he may change his trade as often as he pleases."[1]

Not all of these ideas are in acceptance today, but they have developed into the general proposition that selling price must cover cost in the long run if the supply of a product is to be maintained. There is considerable disagreement as to the meaning of cost, and inasmuch as the cost of a product is the result of a great many factors, including judgment and opinion, it is likely that there will always be disagreement as to its meaning. Part of the present article is devoted to a consideration of various types of cost and the relationship of selling price to them, though it is impossible more than just to touch upon the subject here.

Whatever may be the exact meaning of cost, cost and supply are Siamese Twins, and if in the long run the cost is not covered by selling price, the supply will die from lack of nourishment. The pressure from various sources which forces downward revisions of prices can be relieved by reductions in cost, but if the pressure over a long period is such that successive reductions in cost are inadequate to meet it, then supply will be decreased through voluntary reduction in output, voluntary transfer of capital to the production of other goods, or through the failure or bankruptcy of the less efficient or financially weaker producers.

The most important relationship of cost and selling price is that the cost at any given time represents a resistance point to the lowering of price. In time, if reductions in cost do not keep pace with reductions in selling price, the supply of the given commodity will be reduced. In the long run those who wish to be supplied with the commodity must pay a price that will cover cost, including a reasonable margin of profit if the supply is to be kept healthy.

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[1] Adam Smith, *The Wealth of Nations*, Book I, Chap. VII.

WHOSE COSTS HAVE THE MOST EFFECT ON SELLING PRICE?

As a practical business matter we know that at any given time within an industry there are marked differences in cost as between one producer and another. We may then well inquire as to whose costs will have the most effect on selling price in the long run.

In the extractive industries, such as mining and agriculture, the costs of the marginal producers have the greatest influence on price in the long run. Nature has caused permanently different costs as between producers. Under these conditions, as Taussig has said, "The point about which oscillations range and to which price tends to conform is cost for the least advantageous producer. Without him, the total supply cannot be enlarged to the point at which there is an equilibrium of normal supply and demand. If indeed there were no limit to the amount which the more advantageous producers could bring to market—if this fortunate set could increase the output indefinitely at constant cost—the marginal producer would be driven out, and the conditions would be those of constant cost. There being such a limit, he must be called on for the maintenance of supply, and there must be in the long run a price which will make it worth his while to contribute. Value is then determined by cost to the marginal producer; but at what point in the varying scale of costs that producer will be, depends on the conditions of demand." [1]

In manufacturing industries, on the other hand, differences in cost as between one producer and another are not permanent. There is opportunity for the less efficient producer to improve his condition, and the more efficient producer of today may in one way or another lose his relative standing. The more efficient producers tend to displace those who are less efficient. Under these conditions it is the cost of production of the average company, in the sense of Marshall's "representative firm," which tends to have the most effect on selling price in the long run. He described such a firm as one, "which has had a fairly long life, and fair success, which is managed with normal ability, and which has normal access to the economies, external and internal, which belong to that aggregate volume of production [the scale of production in the industry]; account being taken of the class of goods produced, the conditions of marketing them and the economic environment generally." [2]

Many businessmen fail to see anything of practical importance to them in the concept stated above of the long-run relationship of costs and selling prices. It is self-evident that a company cannot continue indefinitely to sell below cost. Executives of companies that are knowingly selling below cost hope that in the long run prices will improve or costs will be reduced. Barring these possibilities they hope to be able eventually to change the nature of their production, or if this is not feasible, to salvage all they can as long as something above out-of-pocket expenses can be realized. In the meantime they are continually beset with immediate or short-run problems that absorb their time and effort and even cast a short-run shadow on their long-run thinking.

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[1] F. W. Taussig, *Principles of Economics*, 4th ed. (New York, Macmillan, 1939), Chap. 13, Sec. 2.

[2] Alfred Marshall, *Principles of Economics*, 8th ed. (London, Macmillan, 1920), Book IV, Chap. XIII, Sec. 2.

LACK OF COST AND SELLING PRICE RELATIONSHIP WHEN COSTS ARE UNKNOWN

One matter of practical importance is that except over an extremely long period cost does not offer an effective resistance to the lowering of price in an industry in which the average company has little or no knowledge of its costs. In such industries it is common for businessmen to say that selling price is based solely on market conditions, meaning that costs have little or nothing to do with selling prices. It is not far from the truth, however, to say that selling prices in these industries are based on lack of intelligence. Under such conditions it is extremely difficult for even capable executives who know their costs to operate at a profit.

The shoe industry, for example, has suffered from a number of ills, not the least of which has been the lack of knowledge of costs. An executive in this industry has said that in his opinion "not more than 15% of the shoe manufacturing companies have anything approaching an accurate knowledge of their real costs." [1] He also stated that his estimate had been criticized by a management engineer who said that the figure was not more than 8%. Under these conditions, according to the long-run proposition stated above, we would expect a withdrawal of supply as a result of failures. We find failures certainly, but there appears to be an inexhaustible supply of newcomers who are willing to throw away their life's savings by going into the shoe business. A study of business mortality in the shoe manufacturing industry revealed that "in the decade 1926–1935 more than one shoe firm out of six ceased business in each year. The average life of all firms that did business in the period 1905 through 1935 was only about six years. Approximately half of the shoe firms that started business in any year had gone out of business by the end of the third year thereafter." [2]

Owners of small job printing plants, small trucking concerns, and garages are notoriously unaware of the cost of doing business, and the list might be extended to cover a number of other industries. Many companies in such industries are not operating as going concerns but are merely passing through orderly liquidation without realizing it. When these companies fail, it is the owners who fail, but the properties are usually sold to newcomers who continue the process of liquidation, often temporarily enjoying a profit because of the relatively low investment cost at which they entered business. Not infrequently these newcomers cut selling prices because of their lower "costs" and thereby force competitors to join the spiral of liquidation. The textile industry, among others, has had quite a taste of this.

In summary at this point, cost offers a resistance to the lowering of selling price, and in the long run selling price must cover cost if those who wish a given commodity are to be supplied with it. Except over an extremely long period, cost offers no effective resistance to the lowering of selling price in industries in which the average producer has no knowledge of costs. Under these conditions, cost becomes effective only after generations of people have lost their savings and the idea finally permeates that it does not pay to invest in these industries.

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[1] Harold S. Wonson, "The Application and Uses of Standard Costs in the Shoe Industry," N.A.C.A. *Bulletin* 256 (Nov. 1, 1936), p. 18.

[2] Horace B. Davis, "Business Mortality: The Shoe Manufacturing Industry," *Harvard Business Review*, Vol. XVII, No. 3 (Spring, 1939), p. 332.

PRICE DEPENDS UPON BOTH DEMAND AND SUPPLY

Depression conditions, and the spirit of defeatism arising therefrom, have strengthened the popular belief that selling prices are based on market and bear no relation to cost. This belief overlooks the fact that it takes both demand and supply to make a market, and broadly speaking the supply side when expressed in dollars is the cost of production and distribution. For every purchase there must be a sale, and price takes into account the interests of both buyers and sellers, though at any given time the interests of one group will be dominant.

In dealing with the influence of both demand and supply on price, Marshall likened demand and supply to the two blades of a pair of scissors. He said, "We might as reasonably dispute whether it is the upper or the under blade of a pair of scissors that cuts a piece of paper, as whether value is governed by utility or cost of production." [1] At any given time one blade may seem more active than the other, but it takes both blades to do the cutting. Cost then offers a resistance to the lowering of selling price not only in the long run but also in the short run, though the effectiveness of this resistance is subject to considerable variation, and tends to increase with the increase of the period under consideration.

DIFFERENCES BETWEEN INDUSTRIES IN THE RELATION OF COSTS AND SELLING PRICES

In some industries cost offers a more effective resistance to the lowering of selling price than it does in others. Industries have been mentioned above in which the lack of knowledge of costs does not give cost a chance to act as an effective resistance.

In contrast, the steel industry is led by large companies in which cost accounting as an aid both in managerial control and in price policy has been developed to a high degree. These companies tend to restrict production when selling prices do not bear a satisfactory relationship to costs, and the withdrawal of supply tends to correct the condition.[2] It is evident, however, that under depression conditions these tendencies have weakened. Indeed, judging by the remarks of Mr. Ernest T. Weir,[3] Chairman of the National Steel Corporation and President of the American Iron and Steel Institute, . . . price policy throughout the steel industry has softened to an unhealthy degree. Much of the substance of Mr. Weir's address appears in the following quotation:

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[1] Marshall, *op. cit.*, Book V, Chap. III, Sec. 7.

[2] Thomas H. Sanders, *Cost Accounting for Control*, 2d ed. (New York, McGraw-Hill, 1934), p. 23. "It is common knowledge that the more powerful steel corporations will close down their plants rather than sell below prices which they consider will give them a fair return for their outlays."

[3] "Profits and Patriotism," an address at the annual meeting of the American Institute of Steel Construction, Oct. 17, 1939.

> Management has not been profit-minded. Instead, it has attempted to conduct business on a basis of losing as little as possible. It has resorted to dodges and stratagems with which we are all too familiar—such as deliberate acceptance of unprofitable business in the hope that the increased volume will cut overhead costs enough to make it possible to break even or escape with a small loss while holding an old customer or getting a new one. It has justified acceptance of business at a loss on the theory that this unprofitable business would pay in the long run by helping to maintain plant, equipment and personnel. No such attempts to rationalize acceptance of business at a loss can be right. Losing business remains losing business. It produces a loss in the first instance, and human nature being what it is, when one producer gives an unwarranted price, competitors meet competition. The result is that the concession sets a new industry-wide price still farther below the level of profits and even of costs. This procedure has been taking place in industry during the past ten years. Management, which after all is hired by the stockholders to make profits, has failed in its principal duty.
>
> Yet the cure for this condition—in your industry, in mine and in all others not controlled by government—is in the hands of management. Management simply has to determine now and at all other times that it will not accept business at a price which does not include costs and a reasonable profit. In saying this, I am not suggesting that companies in an industry get together and agree on prices. There are many phases of business on which companies can cooperate through their trade associations to their own and the public benefit. Price is not one of them. A price policy is one that must be established by each individual company in accordance with cost and other factors peculiar to that company. The job of each individual company is to see that its prices cover its own costs, not empirically established average costs of its industry.

Possibly Mr. Weir overstated his case for the sake of emphasis and did not expect to be taken too literally. Nevertheless, his remarks deserve, and have in fact received, considerable attention.

There are certain industries in which the products have a high degree of uniformity and in which the manufacturing costs tend to be uniform, as in the production of staple commodities, such as flour, sugar, and certain types of textiles. Here the relationship of cost and selling price is very close. As Taussig has said, "Those staple articles which are used regularly from year to year in much the same quantities are sold at prices which are surprisingly close to constant (i.e., uniform) costs." [1]

Custom has established fixed prices for certain products, for example, cigars at 5 cents, 10 cents, 15 cents, and two for a quarter, which bear no relation to cost at least in the short run. From time to time there will be slight changes in prices charged to wholesalers and retailers, but these are more likely to be motivated by price wars between manufacturers than by changes in cost. Over a long period the quality of the product is likely to change, representing an adjustment of cost to the fixed selling price. In this sense there is here a long-run relationship between cost and selling price.

Vice President Marshall made the famous remark, "What this country needs is a good 5-cent cigar." In recent years that prayer has been answered; in fact, some companies have gone so far as to say that the cigars they used to sell at 10 cents are now being sold at 5 cents. My cigar smoking is of comparatively recent origin, and while I think that these cigars are very good 5-cent cigars, I can appreciate that if the same quality sold at one time for 10 cents, there must truly have been a crying need for a good 5-cent cigar.

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[1] Taussig, *op. cit.*, Chap. 12, Sec. 4.

For some years now there has been an increase in the number of consumers' goods sold at fixed prices, fixed in the sense of single prices advertised by the retailer over quite a period of time, as distinct from minimum retail prices suggested by manufacturers. For example, a clothing house will sell all suits at $22.50 per suit. Such prices are not so difficult to change as are prices for goods that are based on the denomination of coins, but they do set up rigidities in the price structure and delay the adjustment of selling prices to changes in cost, particularly when raw material prices are rising. Though adjustments can be made in the quality of the goods sold at the single price, they must be made very cautiously if customer goodwill is to be retained.

There are some consumers' goods not advertised at fixed prices but for which the consumer has become accustomed to paying a certain price, and on which minor changes in quality can be made without unfavorable consumer reaction. Shirts and neckties, at least those on which the quality has not been highly advertised, are in this class of goods.

In the textile industry, it is commonly said that market sets the price. It would be unrealistic, however, to deny that price at least takes into account the available supply, or current cost, of raw material. Furthermore, manufacturers will do what they can to adjust the raw material content and structure of the cloth to bring down the cost so that a profit can be realized at the given market price. Thus, though we can say here that the price is set by the market, it is not correct to say that this price is devoid of any relationships to cost. Cost may not directly determine the price, but in this case it tends either to discourage production on the part of those who cannot cover their costs under the given price, or to determine the quality that can be produced for the given price.

Thus far we have been considering cost in general terms, and certain fundamentals with respect to the relationship of cost and selling prices, particularly in their long-run aspects, and in certain selected industries. Let us now examine the type of cost knowledge available to an individual manufacturing company, say one of Marshall's representative firms with respect to its relationship to prices and effect on pricing.

Historical Product Costs

Part of the work of the cost accountant involves ascertaining and recording the costs of products manufactured. Many believe that this is all that a cost accountant does, but while this task may occupy the full time of several people, it is by no means the only duty of the cost accounting department. Though the cost accountant gathers historical records of cost for the books of account, and in particular for the valuation of inventories and for the determination of cost of goods sold, and though he supplies management with cost figures of one sort or another to be used as an aid in pricing, his chief function is to supply management with cost information and standards of measurement as an aid in controlling the operations of the business.

Product costs gathered currently by the cost department are not of immediate aid in pricing, nor do current prices necessarily bear any relationship to them. The actual material, labor, and overhead costs of products as gathered on cost sheets are subject to temporary fluctuations through changes in price and variations in yield of material; through changes in labor rates and efficiency; through price variances in certain types of overhead and differences of efficiency in the utilization of plant and equipment; and through variations in the volume of operations.

Accounting figures are a blessing in that they provide a means of expressing the ebb and flow of a business. They are a curse in that they imply an air of accuracy and finality that is misleading. The historical cost of any product involves cost allocations based on judgment, opinion, and custom, and is subject to the variations mentioned in the previous paragraph. Over a period of time a body of cost information can be built up so that it is possible to develop average product costs that may be of help in pricing, particularly where prices have to be set that will be maintained for some time in the future, but the current cost of a product should not be taken literally for current pricing purposes.

This statement does not mean that the current unit product cost should be ignored; it should be compared with the current selling price of the unit as one measure of the profitability of current operations. If the profit margin is below normal, management may thereby be stimulated to seek cost reductions, greater volume, or better prices. Needless to say, there are many other factors besides current unit product costs and current selling prices to be considered in executive action aimed at improving the profit situation. Two of these factors, for example, are the current volume of sales and the selling costs by types of product. Some executives have been known to think of the profitability of a given product only in terms of its gross profit per unit. The failure to take into account the volume of sales and the selling costs of each type of product is very dangerous. Not long ago a manufacturer with whom I am acquainted proposed that great effort should be expended to obtain more sales of one of his company's products on which the per unit gross profit was comparatively high. The facts were that this product had very limited uses, and a salesman who concentrated his efforts on selling it would not be likely to obtain more than a five-dollar order for it per day. If any shift in sales effort was called for, it was toward concentration on items that showed a relatively low per unit gross profit, but also had a low per unit selling cost and relatively large volume of sales, and made the greatest contribution to the net profit of the business.

STANDARD PRODUCT COSTS

As was stated above, an averaging of actual unit product costs over a period may be undertaken to remove the purely temporary cost fluctuations and provide management with a more accurate picture of product costs. The same thing has been accomplished by many companies through the development of standard costs. Standard costs have been used primarily as the basis of a technique for control over costs, but they have also provided many executives with a foundation of cost knowledge, which when used with caution and common sense has been helpful as one aspect in pricing.

Sometimes businessmen when supplied with standard costs are inclined to accept them too literally. I recall an executive who, after considerable persuasion on the part of accounting consultants, adopted standard costs. A file of standard costs per unit of each product manufactured was developed as part of the system, and it taxed the powers of persuasion of the consultants to the limit to prevent the executive from drafting these costs bodily into his price policy and from refusing ever to sell at prices that were below them.

In some companies standards underlying the standard product costs are so set as to constitute goals for attainment that are beyond normal expectations. While this may be satisfactory for operating and control purposes in some companies, the standard product costs developed by the use of such standards are too low to be used as a satisfactory basis for the cost side of price considerations. Standards based on good average performance are more satisfactory for the latter purpose.

Standard costs are commonly adjusted at the outset of a new manufacturing season, which in many companies means that they are revised twice each year. In some companies they are adjusted at more frequent intervals in accordance with significant changes in raw material prices, or labor rates, or with significant changes in overhead costs, or volume of operations.

If standard costs are to be used in price considerations in industries in which finished goods prices tend to fluctuate with raw material prices, they should of course be adjusted with changes in raw material prices if they are to be of practical value, since the replacement cost of the raw material at the time a price is quoted for a product is of greater significance to the price than an average cost would be; in fact it is of greater significance to price than is the actual cost of the raw material that will be used to make it.

With respect to the overhead cost element in standard costs, practice varies between companies as to the volume of operations assumed in determining standard overhead rates, upon which in turn, standard product overhead costs are based. The major difference is that some companies base their rates on costs and volume expected in the coming period, while others use the costs and volume expected under normal conditions.

An executive, whose company uses the volume expected in the coming period in determining standard overhead rates, told me, "We do not fool ourselves by using an arbitrary normal volume. What we are after is representative actual costs." An executive in another company, who believes in loading costs in accordance with what the traffic will bear, expressed quite the opposite objection to the use of a normal volume by saying, "When business is good, the overhead costs (of products) based on normal volume are not high enough, and when business is poor they are too high." The latter executive would have to admit, however, that as volume rose above normal, the standard product cost derived from rates based on normal volume would be higher than the actual cost per unit of product (because the actual cost would involve the division of fixed charges by a greater number of units of product); and, conversely, as volume fell below normal the standard product cost based on a normal volume would be lower than the actual cost per unit of product. The same would be true in a comparison between standard product costs developed from rates based on volume expected in the coming period, and standard product costs developed from rates based on normal volume.

While psychological or operating benefits on the one hand and financial expediency on the other may validate the opinions expressed by these gentlemen, it seems to me that the use of normal volume is more helpful in price considerations. The least that can be said is that standard overhead product cost based on normal volume provides management with a workable concept of one element of long-run cost that it should seek to recover in the selling price in the long run.

SUMMARY ON ACTUAL COSTS AND STANDARD COSTS

In summary, with respect to the actual costs of products gathered by the cost accounting department, such costs are only indirectly of aid in pricing and bear no necessary relationship to current selling prices. Standard product costs adjusted in accordance with significant changes in raw material prices and labor rates, and with overhead derived from rates based on the normal volume of operations, are more helpful in pricing than are actual product costs. Standard product costs or a body of actual product costs gathered over a period and used in conjunction with supplementary information, or the two together, are of aid in determining the profitability of each type of product manufactured, prevent management from unwittingly selling below cost, serve as a resistance to the lowering of selling price, and stimulate efforts toward cost reduction, improved sales volume, and better prices. This cost information compared, where possible, with the costs of other companies provides an individual concern with information on one aspect of its relative position in the industry, which is an important factor in price policy. It is understandable that most companies are not charitable with respect to releasing cost data, and unless figures have been gathered by a trade association or research bureau, the relative position of a company with respect to costs of production can only be determined in a roundabout fashion by taking whatever information is available and filling in the missing links by conjecture and deduction.

SPECIAL COST STUDIES ON NEW PRODUCTS

In pricing a new product it is desirable to estimate its costs under various volumes of production (basing this, in so far as is practicable, on records of previous experience with respect to the operations through which the new product will pass), and to compare these costs with estimates of expected receipts from various volumes of sales at assumed selling prices; the object being to arrive at an attainable volume of production and sales that will bring in the largest total net receipts. In the classroom it is a simple matter to assume a demand curve and a supply curve to arrive at a theoretically desirable price. In practice, it is very difficult to develop for a new product either a demand curve or a supply curve that can be accepted with confidence. The cost accountant knows well the difficulties of determining the cost of existing products at existing volumes, let alone the difficulties of predetermining the cost of a proposed product at proposed volumes of production. With respect to demand, it takes a combination of judgment based on experience, deduction based on tests or on the apparent experience of others now in the market with products of a similar type or class, intuition, imagination, and crystal gazing to estimate what the demand for a new product will be at various prices. For that matter, it is not a simple problem to estimate the future demand for a product that is already on the market and on which a price has been established. To date, though great strides have been made in the techniques of forecasting demand, it is still, particularly because of changing conditions and because of the human factors involved, much more of an art than it is a science.

One way of looking at the cost of a new product is to consider as the cost only the additional expenses involved in producing it. Cost would then be composed of the cost of raw material and labor expended on the product, the variable overhead expense that would not have been incurred had the product not been taken on, the fixed charges on any new plant or equipment purchased to produce the product, and any additional selling expense involved. As a refinement we might add to this interest on the capital required to finance the production and sale of the product, provided that the same capital could otherwise be employed elsewhere.

If the possible increment receipts from sales exceeded this increment cost, it is evident that in so far as these factors are concerned, the company would be better off to produce and sell the new product than it would be not to do so. Regardless of how one might feel about computing cost in this manner, it does set a rock bottom to the selling price that can be accepted without incurring an immediate out-of-pocket loss.

One of the dangers of placing too great emphasis on costs solely in terms of the additional costs involved in producing a new product is that management may be moved to set selling prices lower than is necessary under the actual conditions of demand. If the demand could be ascertained with accuracy, there would be little danger of this, but in most cases estimates of demand are not too reliable, and the temptation is to take the defensive and to quote prices that are lower than warranted.

Carelessness in placing too great emphasis on increment costs in pricing a new product may hurt a company by spoiling the market for future sales, and by causing unfavorable reactions of other producers. An extreme example of the latter situation is when one company enters the field of another company by selling a new product priced slightly above increment cost, whereupon the second company retaliates by entering the field of the first company with a new product also priced on an increment cost basis, and both companies find themselves worse off than they were before the whole thing started.

If we propose to take on a new product for a short time to make use of idle capacity, or to provide work for employees, and if we can see no danger of repercussions, the additional costs involved in producing the product will be the most helpful type of cost analysis. This might also be the case if the proposed new product is needed to fill out our line largely as a service to customers. This type of analysis, coupled with demand analysis, would also be most helpful if we can shift readily from one type of product to another and are trying each year, or each selling season, to maximize our profits.

If we are contemplating bringing out a product that is new to us but that is already being produced by others in a highly competitive market, it is likely that we will have to accept the market price as given and study our costs to see whether or not we can enter the market and realize anything above them. If we intend to enter the market for a short time only, and can foresee no unfortunate repercussions, the additional costs involved will be the major cost consideration. If we intend to stay in the market and have the new product become one of our major products, short-run cost considerations will not be enough. In other words, if the new product is to become a member of the family, it should take up a fair share of cost and profit responsibility.

In bringing out a new patented product that is not now on the market, the major consideration is the probable price people will be willing to pay for it, and cost is a minor factor. With the passing of time, changes take place causing a narrowing of the margin of profit and the development of a relationship of selling price and cost, at least in the sense that cost offers a resistance to the lowering of selling price. In the old age of the product the selling price may have been worked down until it covers, with little or no margin, only the additional costs incurred in producing it, though it is possible in some cases that, by this time, the demand may be restricted to a relatively few consumers who are attached to the product for one reason or another and are willing to pay a good price to obtain it. In industries of this type, profitable operation depends upon the maintenance of a healthy average age of products by the periodic development of new products to take up the cost and profit responsibilities that can no longer be borne by products reaching old age.

RELATIONSHIP OF VOLUME, COST, AND SELLING PRICE

Businessmen are often tempted to reduce prices on existing products in an effort to increase volume, the aim being to spread fixed costs over a larger volume of production and thereby more than make up for loss in price. The concept not only involves a careful estimate of the extent to which demand can be increased by a given decrease in price, but also a careful estimate of what the costs will be under the increased volume. Such studies often reveal that it will take a considerable increase in volume to make up for the loss in price, and this statement of course is especially true where variable costs constitute a large portion of the total cost of a product. On the other hand, the results from lowering price have in many cases been far more beneficial than was anticipated. Not infrequently management has found to its surprise that a net benefit has been received from a reduction in price even though the reduction may have been forced by competitive conditions. Both short-run and long-run considerations are involved in any reduction in price, including the possibility of spoiling the market and the probable action of competitors if prices are lowered.

Earlier in this paper, mention was made of actual product costs as compiled in the cost records, and of standard costs based on a normal volume of production. It is also desirable for control purposes, and for planning operations and financing, to know the costs (i.e., costs by items, as distinct from product costs) at various volumes of operation. This is of particular importance with respect to variable overhead costs. At the present time many of the leading concerns in all types of industry are developing variable budgets in connection with studies of costs under varying volumes of operation, and such studies and budgets related to financial results are indirectly of aid in pricing.

CONCLUSION

Businessmen are aware of the long-run relationship of costs and selling prices, and in the case of their own enterprises they know that despite blood transfusions of new capital, in the long run these enterprises cannot be kept alive unless income matches outgo. But the long run seems forever to be in the future, until it is too late to do anything about it, and it is rather popular to regard pricing as a short-run problem in which costs can be ignored, sometimes forgetting that one day slips into another and the long run is actually a series of short runs.

It is not the contention of this article that selling price should be based on cost in the short run, but it is the contention that cost should constitute a resistance to the lowering of selling price in the short run as well as in the long run, and it cannot do this if it is ignored or if knowledge of it is inadequate. Used with common sense the utilization of cost, not as the basis of price but as a resistance to the lowering of price, should not introduce undue rigidity in pricing.

In companies in which cost accounting is reasonably well developed, management is supplied with various types of cost information, some of which is of aid in price considerations. That unit product costs, either actual or standard, have often been accepted too literally by management and drafted bodily as the basis of prices, without adequate attention to other factors, has not usually been the fault of the cost accountant. He can, however, be blamed for not always supplying the most useful type of cost information, and for not educating management as to the sources and limitations of the cost information supplied.

In view of the inadequacy of a brief treatment of the relationship of costs and selling prices, it is appropriate to close with the following warning given by Marshall in comparing the world in which we live with conditions in a "stationary state":

> Here [in the world in which we live] every economic force is constantly changing its action, under the influence of other forces which are acting around it. Here

changes in the volume of production, in its methods, and in its cost are ever mutually modifying one another; they are always affecting and being affected by the character and the extent of demand. Further all these mutual influences take time to work themselves out, and, as a rule, no two influences move at equal pace. In this world, therefore, every plain and simple doctrine as to the relations between cost of production, demand and value is necessarily false: and the greater the appearance of lucidity which is given to it by skilful exposition, the more mischievous it is. A man is likely to be a better economist if he trusts to his common sense, and practical instincts, than if he professes to study the theory of value and is resolved to find it easy.[1]

PRICING OF GASOLINE: A CASE STUDY

BY EDMUND P. LEARNED

This article is a case study of the prices to dealers and prices to consumers at company-operated stations for regular-grade gasoline of the Standard Oil Company (Ohio) for the period from 1937 through 1947. The management of that company had asked the author, as an outside consultant, to summarize historically the facts regarding these prices for the internal use of its officers and marketing executives. It soon became clear that this material would be of value also to people outside the company—both to those who are directly interested in price theory and marketing practice and to those who are more generally concerned with promoting better understanding of the realities of business life.

State-wide prices had been posted by the company in the Midland Building in Cleveland for years and had been printed in trade journals, and local variations from these prices had been issued to the marketing divisions in price letters and were public knowledge of the trade in the areas affected. It was, therefore, a further step in the same direction for the company to grant the author permission to use the historical facts included in this article. It should be noted, however, that any interpretation of the economic or social significance of these facts or any statement of issues implicit in this body of material is the author's sole responsibility. The company has not been asked to approve the author's interpretations and may disagree, of course, with some of his remarks.

Few companies have been willing to reveal as much of their own thinking and policies as is contained in this article. The author wishes to acknowledge publicly his appreciation of the forward-looking, enlightened attitude which has prompted the release of this material and has thus made available to marketing experts, to economists, and to the public in general this "inside look" at how management reacts to markets and how it deals with the price-making process.

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[1] Marshall, *op. cit.*, Book V, Chap. V, Sec. 2.

Source: *Harvard Business Review*, Vol. XXVI, No. 6 (November, 1948), pp. 723–756

PURPOSES

One of the major purposes of this article is to help bridge the inevitable gap between economic theory and everyday fact. For this reason the contents that follow should be placed in their proper setting in economic theory.

Economic Theory. According to the definitions of many economists, a large share of American business is conducted under conditions of "monopolistic competition." When types of competition are arranged on a scale, at one extreme there is pure competition, next a wide band of monopolistic competition, and finally a very small range of pure monopoly. In pure competition, products are standardized and no seller or buyer is large enough to have any control over price. In pure monopoly, on the other hand, it is assumed that the monopolist has a capacity, through his control of supply, to set a price which will maximize his net income, usually but not necessarily at a higher price than would prevail under pure competition.

In the wide in-between band of so-called monopolistic competition products are differentiated, branded, and advertised; particular suppliers are likely to render services that make them unique in some degree from other suppliers; and it is assumed that individual sellers (or buyers in special cases) are few enough in number so that each has a significant effect on price, sometimes a strong enough effect to be described as "price leadership." It is further assumed that because the number of competitors is relatively small, each can watch the policies of others and modify his own behavior accordingly. The economists generally assume, also, that there is a minimum of price competition and a maximum of other forms of competition for advantage, and that prices under monopolistic competition tend to be higher than under pure competition.

Much of the reasoning of economists has been based upon assumptions too often unrelated to reality. Their conception of consumers' behavior is not always corroborated in the businessman's experience. Their assumptions concerning the businessman's response to cost considerations are frequently incomplete or wrong. Given their assumptions, they reason effectively to theoretical conclusions. It is one point of this article that businessmen should furnish more facts about price making in order that economists will have a basis for their theoretical analysis and will not be forced to reason in a vacuum. This is particularly important in view of the fact that legislators and public policy makers frequently use the theoretical conclusions of economists as the basis for social judgments or legislation regarding the process of competition and the scale of business organization. The good economist knows the limitations of his theoretical methodology and appreciates the wisdom of checking his assumptions against facts, but there are many other people who do not.

In theory the descriptive words, "monopolistic competition" and "price leadership" have a technical meaning, and there is no ethical or moral tone attached directly to them. In fact, however, many economists, if not the majority, behave as if monopolistic competitors and price leaders were guilty of something antisocial. No doubt some are, but certainly not all. In view of the complexity of business and the many forms of so-called monopolistic competition, it seems unwise to make sweeping generalizations. Sound social policy can only be based upon a careful study of specific cases. It is altogether probable that one can draw conclusions from the case study in this article, or even from the oil industry as a whole, and yet be unable to apply them automatically to another industry without first investigating the detailed facts of market behavior and business organization in that other industry. As a matter of fact, much of the significance of this article lies, not in any possibility of generalizing on its specific findings, but in the cumulative effect of the data in demonstrating how dangerous such generalization would be.

When the author told the executives of the Standard Oil Company (Ohio) that economists would describe the company as a "monopolistic competitor," they said that they did not like the term. To them, it suggests collusion and abuse of power, and both are anathema. As executives faced with the pressure of many different forms of competition for advantage by quite a variety of competitors, they would place great emphasis on the word "competition" and none on the word "monopolistic." The author urges the reader to look at the facts presented and to judge for himself whether the emphasis should be upon the word "competition."

Everyday Fact. It is the intent of this article to describe how the company's prices are determined and, more particularly, under what conditions the company leads prices up and why in general it follows the market down. Both prices to consumers at company stations and prices to dealers will be discussed; these are separate business problems blended together in different ways in different localities. Looking at the failures and the successes of the company in so-called leadership and examining the extent to which the company is able to lead or "gets pushed around" will give some idea of the degree of control which a so-called price leader has. Why the company has to experiment in pricing will become apparent as the data are presented.

Aside from facts bearing on these broad questions of monopolistic competition, there will be descriptions of company policy on (1) the level of prices to be quoted (high or low?); (2) the use of state-wide prices and local prices; (3) the company's responsibility to the industry and the public for not injuring small competitors and small business by "throwing its weight around" through indiscriminate price cutting. The action responses of the company to changes in volume resulting from competitive behavior and to market patterns set by local competition will be portrayed.

Numerous other questions of public or business policy will be apparent in the evidence. It is not possible within the scope of this one article to examine every question suggested by the facts. Actual pricing practice is made up of many moves (some major, most of them small) made in response to changing conditions. It is this necessity to adjust currently to the dynamic situation which makes pricing practice different from the theories.

BACKGROUND

The reader may ask whether a case history of this company is representative of the oil industry as a whole. The answer is more "yes" than "no." It is unmistakably "yes" with respect to (1) the forces at work in gasoline markets in the United States and (2) the problems faced by a price leader in stating prices on rising or falling markets. These are fundamental problems, and the Standard Oil Company (Ohio) does account for enough of the sales in its own market, as will be evident later, to raise questions about price leadership.

The answer is "no" in the sense that every so-called price leader may have some unique aspect to his policy which differs from the practices of other leaders in other markets. Some market leaders aim to set uniform prices for states or natural marketing areas, whereas other leaders build up local prices upon the basis of a price at refining points plus handling charges and margins, making local variations from such price structures only to meet competition. Unlike this company, many market leaders do not quote a retail service station price at a substantial number of stations; they have for the most part leased the service stations they formerly owned and operated to dealers who are entitled to name their own prices and to establish their own dealer spread or margin between the prices at which they buy and those at which they sell.

To understand the price policies of the company, it is desirable to have a clear picture of the company and the business environment in which it operates. The Standard Oil Company (Ohio) was one of the Standard Oil companies whose stock was distributed to the stockholders of Standard Oil Company (New Jersey) as the result of the decree of the Supreme Court of the United States entered in 1911. It was not then an integrated company possessing balanced crude resources, pipe lines, refineries, and jobber and retail marketing facilities. It may be classified in 1948 as a partially integrated company.

In recent years the company has integrated backward into crude production and has developed both crude and product pipe lines and river transportation. Most of the development of crude production has been since 1941, however, and the company is still a large net buyer of crude oil and probably will be for some years to come. The price of crude is therefore significant to the company's gasoline price policy. The company has also modernized its jobber facilities, that is, bulk plants and terminals, and has added to its retail service station facilities. Some of the latter are company operated; the majority are leased to dealers. A large number of other dealers who own their stations or rent them from private landlords handle the company's products.

The company is the only Standard Oil company operating under that name in Ohio. The coined name "Sohio" has become synonymous with the official company name and to a great extent has become substituted for it. Individual brand names like "X-70" for regular-grade gasoline and "Supreme" for Ethyl gasoline have been developed for particular products. So far as this article is concerned, .the company operates in two different markets: the retail market and the jobber market.

Retail Market. As an operator of company service stations, the company quotes service station (S. S.) prices to consumers. In this market it sells in competition with dealers who offer (1) the advertised brands of refiners, (2) the brands of jobbers who sell to dealers (or operate chains of service stations), and (3) private brands (sold principally by so-called trackside operators).

In some or all of the counties that it covers, Sohio competes with dealers of other Standard Oil companies or their successors and affiliates: American Oil Company (an affiliate of the Standard Oil Company of Indiana), Atlantic Refining Company, Ohio Oil Company, Socony-Vacuum Oil Company, and Pennzoil Company. The company states that it has no connection with these former Standard Oil companies. In fact, its officers are proud of the fact that Sohio is one of the smaller members of the industry in terms of size. They like to consider themselves independent, and one of their officers stated their attitude in a public hearing as follows: "The company is smaller than some so-called independents, and more independent than any."

It is also in competition with the dealer outlets of the following additional so-called major oil companies: Cities Service Oil Company, Gulf Oil Corporation, The Texas Company, Pure Oil Company, Sinclair Refining Company, Sun Oil Company, and Shell Oil Company. Prominent nearby independent oil companies competing in this market are Ashland Oil and Refining Company, National Refining Company, Allied Oil Company, Quaker State Oil Refining Company, and Freedom Valvoline Company. In addition there are approximately a dozen small refineries in Michigan, Kentucky, and Pennsylvania selling gasoline to dealers in Ohio.

An important type of dealer in the retail market is the so-called trackside or trackage operator. Originally such dealers erected stations with large tank capacity at the side of railroad tracks and received deliveries in tank car quantities—often of low-quality gas, so that the term "gyp station" was sometimes applied to them. These stations typically sold private brands. They were great shoppers for low-cost gasoline; and in by-passing the bulk plant of the oil company or the jobber they eliminated a large part of the wholesale expense and were therefore able to cut the costs of distribution and offer consumers a price appeal.

But now, although the term "trackside" is still applied, an evolution has occurred. There are hundreds of stations with private brands selling primarily on the price-appeal basis, but they are no longer necessarily located next to railroad tracks. Some of the enterprising operators saw the advantage of large quantity, motor-transport deliveries direct from refinery or pipe-line terminals to other than trackside locations. They arranged with their suppliers to obtain a cost advantage arising from this method of delivery.

Moreover, as cracking facilities of the industry increased during the 1930's, these operators obtained a better quality of gasoline. Consumer experience and technical tests showed that this gasoline was usually of satisfactory quality. Some oil companies, including Sohio, which offered premium and regular gasoline, at first tried to meet the new competition with a lower-priced, so-called third-grade gasoline, but found this less and less effective. For that reason Sohio after four years of experimentation with third-grade gasoline dropped its sale during 1936 and 1937 and decided that trackside competition had to be met by price changes in regular gasoline.

Some of these trackside dealers have also improved their service station facilities and have offered more services to customers. In a few instances they now sell the brands of major oil companies.

The Jobber Market. Over half of the gasoline sales made under the Sohio brands are accounted for by dealers to whom the company quotes a dealer price for the delivery of gasoline from its bulk plants or other distributing points. As most readers know, a bulk plant consists of storage tanks, handling equipment, and some warehouse and office space. In this so-called jobber market, the company competes with the oil companies listed earlier (or with jobbers representing them) and with jobbers who have their own brands and shop the markets for supplies.

There is plenty of opportunity for such "shopping." The Ohio market draws upon many refining areas in meeting its demand for gasoline. Depending upon market and price conditions, the supply of gasoline comes by pipe line, boat, barge, or tank car from the refineries of Ohio, Pennsylvania, Kentucky, Illinois, and Michigan, from the Mississippi River refining points, from the Gulf and Midcontinent refineries, and from the Chicago and Detroit refining centers.

Both the retail and the jobber markets have been affected by three significantly different sets of economic conditions marking the 11-year period reviewed here: (1) There was the post-NRA period of adequate supplies of gasoline. This ran from 1937 through 1941 and included a major recession in 1937, a recovery in 1938 and 1939, and a prewar expansion in 1940 and 1941. (2) The second major set of conditions was the regulated price and margin period of the war, which will be given little attention in this article. (3) Since 1945 there has been a third period of unprecedented demand for gasoline accompanied by general inflation in the country.

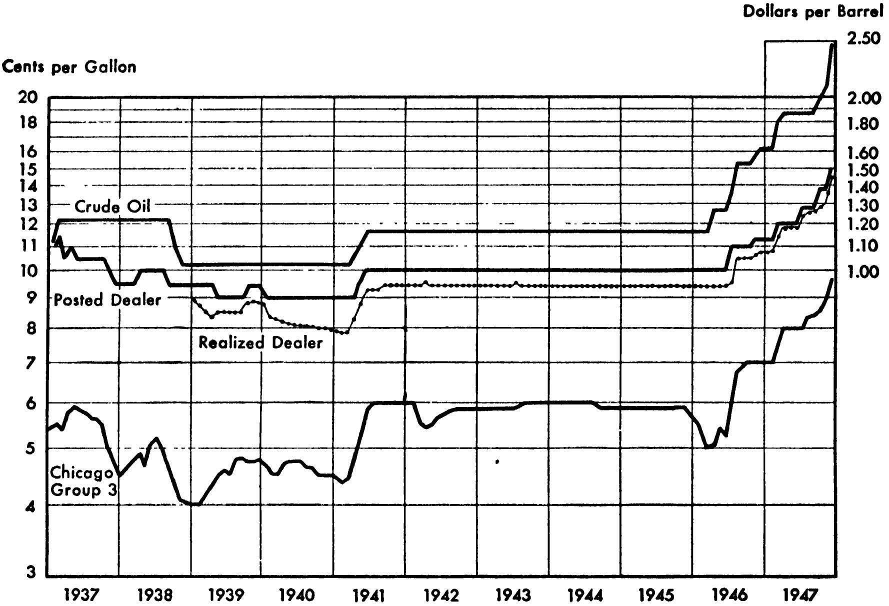
Practice of Posting Prices. When the present Sohio management took over in 1928, the company had dropped from an earlier figure of over 45% of total gasoline sales in Ohio to as low as 11%. After the decision in the dissolution suit in 1911, Sohio, like some other Standard Oil companies, had really held an umbrella over the market through its high-price policy. Companies following such a policy furnished the targets at which old and new competitors could shoot—for example, competitors like Gulf and Shell which were becoming stronger factors in the industry and some of the older companies which were entering new territories. By price concessions, equipment deals, financial aids to dealers, and other devices, competitors took business away from them or kept them from getting their former share of an expanding market. Sohio was not the only company to realize by the middle or late 1920's that it could ill afford to ignore the competition.

The new management of Sohio, by aggressive merchandising and promotion methods, modernization of transportation methods, and rearrangements in sources of supply, along with a more realistic price policy, was able to stop the downward trend in its sales position and to start sales up again. By 1930 the company had almost reached 30% of total sales in Ohio. The company suffered a reversal of trend between 1933 and 1936 which it attributed to the inflexibility of the NRA arrangements. Under the conditions then prevailing the company did not consider the establishment of 2-cent margins for jobbers and 4-cent margins for retailers under the NRA code to be economically sound. It went along since it felt compelled to do so, but because of secret price cutting by competitors below the level set by the government its percentage of total sales dropped to 20%.

It is little wonder after two such experiences that the management has been concerned with finding the genuine economic level for prices and quoting those prices to dealers and consumers. The reader will understand that in the following discussion of the company's efforts along this line all statements, unless otherwise noted, refer specifically to the period being studied, namely, 1937–1947.

Exhibit I

Comparison of Average Crude Oil, Chicago Group 3 Gasoline, and Sohio State-Wide Posted Dealer and Realized Prices, 1937–1947



The posted service station or S. S. price is a state-wide price, posted from time to time at the Sohio office in the Midland Building in Cleveland. It is the price at which the company sells to retail customers at its company-operated stations. The average realized S. S. price may differ from the state-wide posted price because of reductions which apply to certain cities or stations.

The company similarly posts a state-wide dealers' price. Exceptions to this price are made for particular cities or areas as circumstances require, and for that reason the realized dealer price may be less than the state-wide posted price. Exhibit I includes curves on the posted and realized dealer prices.

The difference between the service station price of an independent dealer and the dealer price that he pays the company is the dealer margin. The company does not post such a margin. Dealers buying from the company name their own selling prices. The difference between company posted S. S. prices and dealer prices will be referred to from time to time as a "posted" dealer margin—but the word will always be in quotes as a warning to the reader that it is a convenience of writing and not a company practice.

Company Price Policy. Data on company price policy, which is of course the essence of the article, were obtained by the author in two principal ways. First, company files were surveyed in order to build up the historical record of price actions; and, in order to have a cross section of factors at work in different local markets, the Akron, Canton, Springfield, and Toledo markets were selected for intensive study. Price letters, memoranda, field correspondence on the price and competitive situation and home office answers thereto, and market surveys of the price situation with substantiating photographs of prices in competing stations or own dealer outlets were gathered and examined. Internal memoranda written over the years, often under stress of everyday work, helped materially in piecing together the story of company price policy. These memoranda were not prepared for publication; they were working documents, from which some quotations are made in this article in order to give the reader the flavor of current events and feelings.

Secondly, the vice president in charge of sales was requested to make a written statement of price policy. This independent approach was made in order to determine whether the policy at the field-operating level was the same as that understood by the president and the board of directors. The following statement of policy by the vice president, with its supporting explanation, was found to be a very accurate summary of the company's actual behavior during the period being studied:

> Marketers in a free economy very properly charge the customer the highest price that in their opinions they can afford to ask. The soundness of market prices, therefore, depends upon a full understanding of all those factors which place a ceiling on the asking price, since it is just as important that one's asking price be not too high as it is that it be not too low. The judgment of marketers in setting prices should be affected by such immediate considerations as the probable effect of the proposed prices on sales volume, the probable behavior of future costs under the influence of the proposed prices, the probable reactions of existing competition to such prices, and the possibility of the encroachment of future competition. Prices in each market should be tailored to their own economic environment, and should be built upon one's estimate of the future, based upon the past. This requires the systematic marshalling of all relevant knowledge and price experience.
>
> In addition to such immediate price considerations there are many others more general in nature but none the less dynamic in effect. Among these are the general commodity price trends in other industries, the prices of competing items in other industries, the presence or absence of purchasing power, either generally or in a given locality, and that timely factor now so disturbing, to wit, the bearing of prices upon the inflationary spiral.
>
> Historically, our Company adopted a so-called state-wide price for gasoline, which represented the highest price it believed it could afford to ask after giving due weight to all those factors which might influence prices.
>
> Our own costs are not of primary consideration in setting our prices, although these in connection with those of the industry may later be used as a check. A distinction should be made between costs as a motivating factor in calling for a re-examination of one's price levels, and costs as a determining factor in setting price

levels. In the former costs have a role; in the latter they do not. It is likewise true that on a rising market the attention of management to its price levels is aroused by its costs, while on a falling market the attention of management to its price is aroused by a loss of business. The factors entering into setting prices, however, in either case are exactly the same and must be distinguished from those which have only a warning significance. We realize, of course, that we cannot sell indefinitely below our costs, on the one hand, nor can we expect to sell for very long at prices much above those of our competitors, on the other. The fact that we, ourselves, are not making money in any particular market, after our prices have been properly adjusted to the economies of that market, becomes not a reason for a further raise in that market but rather a spur to our management to find out why we are not making a profit within the range afforded by our competitors and, having determined the cause, to promptly make a correction.

Having set our price objectives on the basis of general considerations, we then tailor them to meet local conditions. In times like the present which are dominated by general conditions, including product shortages, most markets have identical prices. In normal times, such as those immediately before the war when local factors became dominant, uniform prices practically disappear in favor of local exceptions.

In a free market there is, in reality, no such thing as a single market leader or group of leaders. There are usually many marketers in each area whose prices are more or less important to other marketers, depending upon the extent of their distribution. As one of several marketers of that type in Ohio, we find that as a practical matter we can lead the market up under certain conditions, but that politically it is not wise to lead it down.

Economically, in theory, there might be times when a marketer should lead a market to lower and sounder levels. In a market such as ours, which is highly competitive, such leadership is not necessary. It promotes good industry relations to follow the market down belatedly, thus sharing with others the responsibility for achieving lower levels. Politically, we should not be the spearhead which drives uneconomic distribution out of the market. These levels having been set by others, however, we can follow to realistic economic levels.

On the other hand, in our own interest we must usually take the lead in attempting higher price levels when we believe that conditions will permit. Having a substantial distribution in our market, we are confronted with the fact that few marketers, especially those with a lesser consumer acceptance, can take the lead in increasing prices. Upward moves in our market are made by us only when, in our opinion, general prices and the economic pressure from industry costs are such that our competitors in their own interest will follow. It is notorious that when we guess wrong, or when we advance our market too far, immediate market disintegration sets in. Competition never fails to take full advantage of any such opportunity, and when it occurs, as it has in many cases, we must retreat until we find the proper economic levels for our prices.

One of the fallacies often advanced is that so-called leading marketers reduce prices to drive out competition so that they may later enjoy a monopoly. That is like trying to sweep back the ocean to get a dry place to sit down. Competition is impelled by impersonal forces that never scare, and never hesitate for long, and would move in immediately when prices were restored, offering little opportunity to a single marketer to recoup his losses. As a practical matter, selling below cost to drive out a competitor is a sure road to bankruptcy.

Likewise, the belief that markets may be effectively disciplined by initiating temporary price reductions below economic levels is a similar fallacy. Undoubtedly this has been tried, but if experience proves one thing, it is that where industry prices are allowed to seek their own economic levels, as set by free competition, the long run interests of everyone are best served, including both the industry and the public.

The mere fact that competitors may post prices below ours in itself affords no reason for meeting those prices. It is the policy of our Company to react not to a competitor's prices, but rather to any impact from such prices or policies that may unduly distort our volume.

Prices must not be considered alone without due regard to the many variables that accompany prices, which, in themselves, are just as substantial an inducement to the consumer as are prices. Among these are quality of product, character of service, convenience of outlets, and a reputation for customer satisfaction. In reality, therefore, in any market no two competitors ever offer the customer the same inducements. Each very properly appeals to the trade in keeping with his character and personality. In purchasing new outlets this factor cannot be overlooked, since very often the purchaser of high-volume facilities finds in his frustration that he is unable to hold his new bought customers. He overlooks the fact that his appeal may be entirely different from that of his predecessor.

The market place in a competitive economy provides a continuous customer plebiscite in which success depends entirely upon the ability of the marketer to please the customer, at a profit. No member of the industry can expect in the long run to extract more from the community than he contributes. Even self-interests dictate certain moral responsibilities, extra legal, but entirely in keeping with the workings of a system of free enterprise. As marketers, it is unwise for us to throw our economic weight around unduly in any market. If we set prices at uneconomically low levels we unnecessarily injure sound and efficient competitors in addition to taking an unnecessary loss on our own part. On the other hand, market confusion, economic waste and political agitation accompany those markets where most so-called market leaders attempt price levels that cannot be maintained. The unwary are trapped by the inevitable crash which comes under the pressure of economic forces growing out of the resultant over-developed distribution, and these, in turn, tend to seek relief from their plight in such unsound legislation as fair trade acts, price fixing, etc.

To summarize in a nutshell, we believe that the essence of sound pricing is trial and error, a purely grass roots function, and that the faithful adherence by members of the industry to realistic economic levels serves alike the interests of both the industry and the public.

The vice president's view of how valuable it would have been to have had this statement at the beginning of the period rather than at the end probably would be shared by other businessmen. For in this instance, as in so many, it is easier to write the policy after it has been crystallized in the crucible of trial and error than it is to state it while trying to determine what the situation requires it to be. In any event, the above statement will be of help to the reader in understanding the actual pricing data which follow. . . .

CHANGES IN STATE-WIDE PRICES

Until very recently the company posted state-wide service station and dealer prices. An examination of the changes in these prices throws light on some of the broader competitive forces at work. The changes in the state-wide posted service station prices for 1937–1947, with corresponding dealer prices, are shown in Exhibit II. Readers are reminded that the S. S. prices apply to consumers buying from company-operated stations, and the dealer prices to dealers buying their supplies from the company. The state-wide posted price to dealers was uniformly 3½ cents under the S. S. price until late in 1946 when it became 3¾ cents under. The spread was increased to 4 cents in December 1947 for reasons that will be explained in a section discussing dealer margins in some detail.

EXHIBIT II

SUMMARY OF CHANGES IN SOHIO STATE-WIDE POSTED PRICES (EX-TAX) 1937–1947

(Per gallon)

Date	Service Stations		Dealers	
	Posted Price	Price Change	Posted Price	Price Change
2/ 6/37	15.0¢	+ ½¢	11.5 ¢	+ ½¢
3/15/37	14.0	−1	10.5	−1
4/29/37	14.5	+ ½	11.0	+ ½
5/ 5/37	14.0	− ½	10.5	− ½
11/ 4/37	13.5	− ½	10.0	− ½
12/24/37	13.0	− ½	9.5	− ½
4 /3/38	13.5	+ ½	10.0	+ ½
9/26/38	13.0	− ½	9.5	− ½
5/ 5/39	12.5	− ½	9.0	− ½
10/ 7/39	13.0	+ ½	9.5	+ ½
1/27/40	12.5	− ½	9.0	− ½
7/ 1/40	(Tax increased ½¢)			
5/ 6/41	13.0	+ ½	9.5	+ ½
5/29/41	13.5	+ ½	10.0	+ ½
7/27/46	14.5	+1	11.0	+1
11/28/46	15.0	+ ½	11.25	+ ¼
3/12/47	15.5	+ ½	12.0	+ ¾
7/ 9/47	16.5	+1	12.75	+ ¾
10/24/47	17.5	+1	13.75	+1
12/ 9/47	19.0	+1½	15.25	+1½
12/17/47	(No change)		15.0	− ¼

Between January 1, 1937, and December 31, 1947, there were twelve increases in the posted S. S. price: nine of these were ½ cent each, two were 1 cent, and one was 1½ cents. All of the larger increases were in 1947. During the period under study there were seven decreases in the S. S. price: six of these were reductions of ½ cent, and one was a reduction of 1 cent. On either a rising or a falling market the typical unit of price adjustment was ½ cent because company pumps were adjusted to ½-cent intervals.

The effect of economic conditions on the number of changes in price is apparent. The period 1937–1947 was one of generally rising prices following the period of declining prices after 1929. There were six price changes in the recession year 1937, two in 1938, two in 1939, one in 1940, two in 1941, after which there was government-regulated stability through the war, then two changes in 1946, and finally four changes in the inflationary year 1947. Price changes in the three months of large consumption, June, July, and August, were rare.

The following analysis of state-wide posted prices should throw light on such significant questions as: What is the relation of crude oil prices to gasoline prices? Are gasoline price changes made automatically when crude price changes are announced by crude suppliers? Is there a fixed relationship between adjustments in crude and gasoline? What relationship is there between tank car quantity prices and dealer and service station prices? Is there any fixed ratio between these tank car prices and other prices? Does the company use a formula for determining its price structure? Does it use single or multiple basing point prices? Are economic changes and changes in demand and supply conditions for gasoline reflected in its price behavior? What is the frequency of change in its prices?

Relation to Crude Oil Prices. The relation of S. S. prices to crude oil prices is summarized in Exhibit III.

EXHIBIT III

CHANGES IN CRUDE OIL PRICES COMPARED TO CHANGES IN SOHIO POSTED S. S. PRICES

Crude Oil *			Posted S. S. Prices	
Date	Price	Change	Date	Change
	(per barrel of 42 gallons)			(per gallon)
1/28/37	$1.22	+12¢	2/ 6/37	+ ½¢
10/13/38	1.02	−20	9/26/38	− ½
4/ 1/41	1.07	+05	5/ 6/41	+ ½
5/20/41	1.17	+10	5/29/41	+ ½
4/ 1/46	1.27	+10	7/26/41	+1
7/25/46	1.52	+25		
11/15/46	1.62	+10	11/28/46	+ ½
3/10/47	1.87	+25	3/12/47	+ ½
			7/ 9/47	+1
10/15/47	2.07	+20	10/24/47	+1
12/ 6/47	2.57	+50	12/ 9/47	+1½

* Midcontinent 36° gravity.

There is no constant or necessary relationship between the amount of a price advance in crude and the amount of a price advance in gasoline. Increases of ½ cent in gasoline prices have occurred with 5-cent, 10-cent, 12-cent, and 25-cent advances in crude oil prices. Advances of 1 cent in gasoline have been associated with 20-cent and 25-cent increases in crude. Advances of 1½ cents in gasoline have been related to 25-cent and 50-cent increases in crude.

Moreover, the timing of gasoline price moves has been neither automatically nor precisely tied to changes in crude prices. All the increases in crude prices, however, brought about eventual changes in gasoline prices, as is only to be expected in view of the fact that this company is a large net buyer of crude. The reaction time varied from immediately to a lag of as long as three months. On the advances of January 1937 and May 1941 the lag in gasoline prices was from one to two weeks. In April 1946 a 10-cent advance in crude had no effect on gasoline, but a second advance of 25 cents in July resulted in an advance of 1 cent in gasoline. The 25-cent increase in crude in March 1947 not only had an immediate effect of ½ cent on gasoline but probably indirectly contributed to the 1-cent price increase in July. The one decrease in the price of crude during this period was preceded by a reduction in product prices.

Gasoline prices are much more sensitive than crude prices. The state-wide posted S. S. and dealer prices changed fourteen times in the years 1937 through 1941, whereas the price of crude oil changed only four times. The wholesale market for tank cars of gasoline is likewise quite sensitive to changes in conditions of demand and supply, as we shall see from an examination of its economic effect in the next section.

Tank Car Prices and Dealer Prices. The fact that there has been public interest in the relationship of refinery spot quotations for tank car quantities in the wholesale market to posted dealer prices and service station prices makes this aspect of the study particularly relevant.

The wholesale market is difficult to define geographically because, so far as Ohio is concerned, it includes the large and small refineries located in Ohio who sell to jobbers or spot purchasers, as well as to dealers through their own bulk plants, and also the refineries in surrounding states who come into Ohio. At times it will include refineries from as far away as Louisiana or the Gulf of Mexico. There are published spot quotations for some of these points, but there is no continuous series for Michigan, Pennsylvania, and Kentucky, states which have immediate influence on the Ohio market. The most sensitive and dependable price series, the so-called Chicago Group 3 price for tank car quantities (monthly averages are plotted on the chart in Exhibit I), seems to be the best barometer of general market conditions that is available.

The company does not use the Chicago Group 3 prices or any other wholesale prices as the base for setting its prices. On the basis of monthly data, neither its dealer prices nor its service station prices (1) moved up or down simultaneously with Chicago Group 3 prices, (2) moved in the same relative proportion, or (3) during short periods moved in the same direction.

But although the management seems to make little formal use of such wholesale prices in setting its own prices, they do constitute facts to be considered with all the other facts, and there is a certain indirect relation. One of the reasons for this, the author believes, is that the wholesale tank car prices are indicative of changes in the demand and supply for gasoline and that they reflect the impact of periods of depression and prosperity. Even though the total volume of spot sales on which quotations are obtained is a very small fraction of total gasoline sales, these sales have an ultimate though indirect effect on dealer and service station prices. This point will become particularly clear when the details of local prices have been presented.

In the following paragraphs the attempt is made to relate movements in Chicago Group 3 prices to the prices of the company. This analysis in no sense represents cause and effect thinking by the company. It is an outsider's interpretation of economic facts.

Chicago Group 3 prices sagged in March 1937 even though there was no change in the posted crude price; the company reduced its prices 1 cent a gallon to dealers and at service stations. A decided recovery of Group 3 prices occurred in April; the company raised its prices ½ cent on April 29. The Sun Oil Company did not follow, though most other competitors did, and it was necessary for Sohio to return to the original level on May 5. It is impossible to tell definitely why Sun did not follow the company up, but to an outsider with the advantage of hindsight it appears Sun simply evaluated economic trends better than did Sohio in this instance.

After May 1937 and until February 1938 there was a steady decline in Chicago Group 3 wholesale prices from a high of 5.88 cents a gallon in May 1937 to a low of 4.50 cents in January 1938. The deepening business depression of 1937 was clearly affecting the demand-price relationship for gasoline. The posted service station price ex-tax was reduced from the 14½-cent level of May 1937 to 13 cents on December 24, 1937.

The improvement in underlying conditions of demand and supply for gasoline was shown in a strengthening of Chicago Group 3 prices in the early months of 1938; the company increased its posted state-wide service station price ½ cent on April 3, 1938. This increase held until September 26 when local competition revealed that the company's price was at an unsound, high level. Service station and dealer prices were therefore reduced ½ cent. There was weakness in Group 3 prices also. Group 3 prices continued down reaching an average monthly low of 4 cents in December. This was the lowest average monthly price for the period 1937–1947.

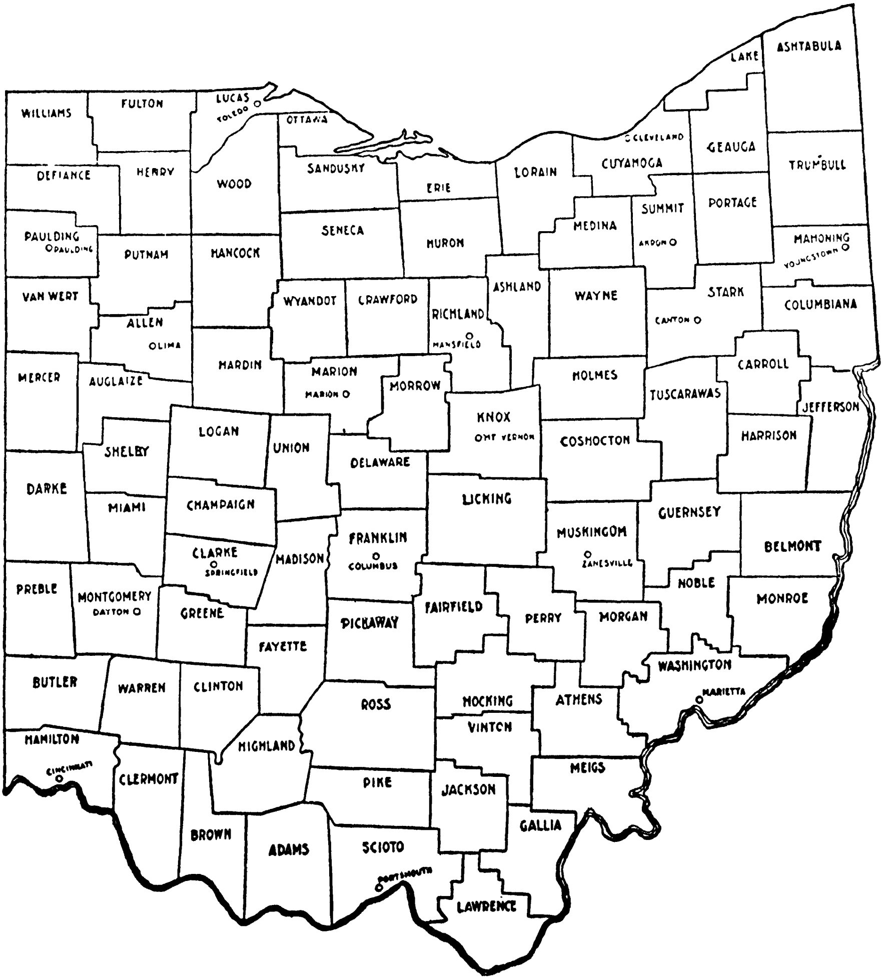
Skipping the period from the fall of 1938 to the spring of 1939 so as to discuss it in detail in the next section, let us continue the comparison thereafter. By October 1939 Group 3 prices had returned to within 20 points of the average for the year 1938; the company cancelled its spring price reduction. Group 3 levels of late 1939 did not hold into 1940; on January 27, 1940, the company reduced its two posted prices ½ cent. Despite further declines in Group 3 prices, the company did not change its posted prices until May 6, 1941, when the price of crude oil advanced; Group 3 prices advanced to an average of 6 cents a gallon. The story of price wars in Ohio cities in 1939, 1940, and the spring of 1941 indicates, as we shall see later, that the low-price gasoline shown in the Group 3 barometer of general market conditions got into Ohio and had its effect, even though state-wide prices were not always promptly reduced.

Effect of Local Exceptions. It is desirable to take an intensive look at the period from September 26, 1938, to May 5, 1939, because it shows what happens to a state-wide price when a basic economic readjustment is delayed. In the fall of 1938 crude dropped 20 cents a barrel, and the posted state-wide prices fell ½ cent. The Chicago Group 3 prices fell more ominously from 5 cents to 4 cents a gallon. On September 26 the state-wide dealer price was 14½ cents with tax, or 9½ cents ex-tax. Of Ohio's 88 counties (see map in Exhibit IV) 7 had dealer prices 1 cent under this level, and parts or all of 14 counties had prices ½ cent under. Dealers in Springfield bought at 1½ cents under the state-wide price. Week by week the structure crumbled. By May 5, when state-wide posted prices were reduced, the price had become *purely nominal.*

In the following summary of what happened it is more important to capture the feel of the crumbling market than it is to try to follow dealer or service station prices in particular places.

EXHIBIT IV

COUNTY MAP OF OHIO



During the week of October 10 to 16, 1938, posted prices in Springfield were raised ½ cent, and the low level of Columbiana County spread to two townships of Carroll County. During the week of October 17 in Akron the dealer price was reduced ½ cent and the service station price 1 cent. Price cutting spread in Lorain County also.

The week of November 28 dealer prices in Williams, Fulton, and Lucas

Counties were reduced 1 cent. And in Toledo the service station price was reduced 2 cents and the dealer price 1 cent.

A reduction of ½ cent was made in dealer and service station prices in Ashland County during the week of December 5; dealer prices were reduced 1 cent in Tuscarawas and Washington Counties. Prices were also reduced ½ cent in Clinton County, thus bringing them in line with Hamilton and Clermont County prices which already were 1 cent under the state-wide dealer posting. During the week of December 12 four more counties—Butler, Warren, Green, and Clark—were brought in line at lower levels with Cincinnati (Hamilton) and Dayton (Montgomery) prices. Darke and Miami and Champaign, the next tier of counties above this low-price area, received reductions of ½ cent the same week. The low-price area around Akron spread further within Summit County, and a new low level was established in Toledo (Lucas County). Price reductions began in parts of Ottawa County the following week. Wayne County and Wooster, Ohio, began in the week of December 19 to reflect the low prices in nearby Summit County. Stark County, next to Wayne and Summit, received price reductions during the week of December 26.

By December 31, 1938, over 30 counties had lower posted prices; 18 of these were 1 cent below state-wide prices, and one was 2 cents below. The centers of price pressure were Cincinnati, Dayton, Columbus, Marietta, Akron, Canton, Mt. Vernon, Paulding, and Toledo.

More and more counties or parts of counties were affected early in 1939. Jefferson, Medina, and Columbiana the week of January 9; Ashtabula, Mahoning, Richland, and Defiance, the week of January 23. Toledo and Lucas County became 2½ cents below the state posting the week of January 23. By the end of January over 40 counties had been affected; most of the reductions were 1 cent under the state posting.

After the middle of February 1939, prices 1½ cents under the state-wide posting were becoming quite noticeable near Findlay and Lima. The eastern counties near Pennsylvania, counties around Dayton, and Washington County also received lower postings. Akron, Canton, and Toledo were going lower.

As of March 31, 1939, only the areas around Cleveland, nine counties in central Ohio, and eleven counties in southern Ohio were unaffected by price reductions.

There is, of course, a closer relation between wholesale tank car prices and crude prices than appears on the surface. The posted price of the large buyers of crude has always been a target of competitors for either secret discounts in periods of slack demand or premiums in periods of tight supply. Thus, crude oil prices as a whole do have an indirect effect on wholesale tank car gasoline prices, and these in turn on state-wide dealer and S. S. prices. When some crude is selling at a discount, it is likely to appear as cheaper gasoline in the tank car market in Chicago or Oklahoma, or as a cheap cargo in the Gulf or New York Harbor markets. These lower car or cargo prices soften up markets and accentuate price competition in the oil industry.

Having quoted state-wide prices and dealer prices on the basis of general considerations, the company posted local prices wherever necessary and for a

EXHIBIT V

SOHIO POSTED SERVICE STATION PRICES (EX-TAX) AND DEALER MARGIN,* 1938–1943

(In cents per gallon)

	State-wide		Akron		Canton		Springfield		Toledo	
	Price	Margin	Price	Margin	Price	Margin	Price	Margin	Price	Margin
1937										
12–24	13.0¢	3.5¢	12.5¢	3.0¢	13.0¢	3.5¢	13.0¢	3.5¢	13.0¢	3.5¢
1938										
4–3	13.5	3.5	13.0	3.0	13.5	3.5	13.5	3.5	13.5	3.0
4–20	....	...	....	...	....	...	....	...	11.5	2.5
4–28	....	...	....	...	....	...	....	...	11.5	3.0
5–7	....	...	....	...	....	...	....	...	13.5	3.5
6–13	....	...	....	...	....	...	13.0	3.5		
7–23	....	...	12.5	2.5						
9–20	....	...	....	...	....	...	11.0	2.5		
9–26	13.0	3.5	12.0	2.5	13.0	3.5	10.5	2.5	13.0	3.5
10–18	....	...	....	...	....	...	11.0	2.5		
10–19	....	...	11.0	2.5						
12–1	....	...	....	...	....	...	....	...	11.0	2.5
12–15	....	...	....	...	....	...	....	...	10.0	2.5
12–29	....	...	....	...	11.0	2.5				
1939										
1–21	....	...	....	...	10.0	2.5				
1–27	....	...	....	...	....	...	10.5	2.5	10.0	3.0
2–14	....	...	10.5	2.5						
2–16	....	...	....	...	....	...	11.0	3.0		
2–18	....	...	10.0	2.5						
5–5	12.5	3.5	10.5	2.5	10.5	2.5	11.5	3.0	10.5	3.0
5–9	....	...	....	...	11.0	3.0				
5–27	....	...	....	...	10.0	2.25				
6–2	....	...	....	...	10.0	2.5				
6–16	....	...	....	...	....	...	....	...	11.0	3.0
6–22	....	...	....	...	11.0	3.0				
8–26	....	...	....	...	9.5	2.0				
9–15	....	...	....	...	....	...	10.0	2.5		
10–7	13.0	3.5	11.0	2.5	10.0	2.0	11.5	3.0	11.5	3.0
10–11	....	...	....	...	10.0	2.5				
1940										
1–27	12.5	3.5	10.5	2.5	....	...	11.0	3.0	11.0	3.0
2–19	....	...	....	...	....	...	....	...	10.0	2.5
2–20	....	...	....	...	....	...	....	...	9.5	2.5
3–1	....	...	....	...	9.5	2.5				
4–6	....	...	10.0	2.5						
5–8	....	...	9.5	2.0						
5–15	....	...	....	...	8.5	2.0				
6–13	....	...	....	...	....	...	....	...	8.5	2.0
7–9	....	...	....	...	....	...	....	...	9.0	2.0
7–12	....	...	....	...	....	...	....	...	10.0	2.5
7–16	....	...	....	...	9.0	2.0				
7–23	....	...	....	...	8.5	2.0				
7–29	....	...	....	...	....	...	10.0	2.5		
8–6	....	...	....	...	....	...	9.5	2.0		

EXHIBIT V (*Continued*)

	State-wide		Akron		Canton		Springfield		Toledo	
	Price	Margin	Price	Margin	Price	Margin	Price	Margin	Price	Margin
1940										
11–29	....	...	....	...	....	...	8.5	2.0		
12–10	....	...	....	...	....	...	7.5	2.0		
12–16	....	...	....	...	....	...	7.0	2.0		
1941										
1–1	....	...	....	...	....	...	8.5	2.0		
1–3	....	...	....	...	....	...	8.0	2.0		
1–9	....	...	....	...	....	...	7.75	2.0		
1–30	....	...	....	...	9.0	2.0				
3–11	....	...	....	...	....	...	8.5	2.0		
4–2	....	...	10.0	2.0	9.5	2.0	9.3	2.3	10.5	2.5
4–24	....	...	....	...	....	...	10.0	2.5		
5–6	13.0	3.5	11.0	2.5	10.5	2.5	10.5	2.5	11.0	2.5
5–20	....	...	....	...	....	...	10.5	2.7		
5–29	13.5	3.5	11.5	2.5	11.0	2.5	11.5	2.7	11.5	2.7
6–18	....	...	....	...	11.5	2.5				
8–26	....	...	12.0	2.5	12.0	2.5	12.5	3.0	12.5	3.0
1942										
3–3	....	...	12.5	3.0	12.5	3.0				
3–11	....	...	....	...	12.0	2.5				
1943										
1–1	....	...	....	...	12.5	3.0				

* Not actually posted; represents the difference between posted S. S. and posted dealer prices.

variety of different reasons to meet local conditions. In times dominated by general conditions of strong demand, product shortages, and inflation, such as 1946 and 1947, the company maintained state-wide prices with few, if any, exceptions. In other more normal times, such as immediately before the war, the record shows that when local factors were dominant, the so-called state-wide price virtually disappeared in favor of local exceptions.

Exhibit V lists the service station price and the "posted" dealer margin for the state and for Akron, Canton, Springfield, and Toledo, during the period from December 12, 1937, through January 1, 1943. We see price weakness in Akron, Springfield, and Toledo during 1938. In 1939 relatively low prices continued in these three cities, and Canton had a substantial period of even lower prices. In 1940 all four cities were below state levels, and a serious price war occurred in Springfield.

In 1948 the management formally recognized that it had in effect abandoned a state-wide price under normal conditions and had gone over to a system of quoting delivered prices based upon competition in local markets. The only vestige of the former practice was the fact that the *National Petroleum News* carried a state-wide price along with prices for each of 13 cities in the state. Effective October 1, 1948, the company formally abandoned the state-wide price and hereafter will furnish the *National Petroleum News* only with its prices for the 13 cities, which the management considers will give a representative cross section of the company's actual prices. It would not be practical, however, to publish in the general press the price quotations of every local market served by the bulk plants of the several divisions of the company.

Changing the method of quoting prices does not of course change the fundamental forces at work in the state-wide market, as discussed above; these will continue to be as strong as ever. But it is evident that a large part of the competitive picture is made up of varying local conditions. Let us look in some detail, therefore, at company practices of the last decade in dealing with local price variations.

LOCAL PRICE ADJUSTMENTS

Whereas the home office took the major responsibility and initiative in setting general state-wide prices, changes in local prices were made on the recommendation of division managers but with the approval of the vice president in charge of sales. The home office was not willing to make price changes on hearsay evidence, and therefore division managers sent letters or reports of conditions and events in their territories. When the local situation required it or the home office requested it, division managers made price surveys, with which they usually submitted substantiating photographs of posted prices in stations included in their reports.

These surveys, most of them made before the war, demonstrate (1) the large number of Sohio dealers who undersold company stations, (2) the wide variation in prices of dealers selling brands of other oil companies, and (3) the extent to which private-brand outlets cut prices. It should be noted that whenever price cutting developed, sales at company-operated stations, which of course maintained the posted S. S. prices, quite often went down, whereas the sales of company dealers, especially those who met the competitive prices, tended to hold their own. The way prices behaved differently in different localities also is significant.

It is not possible to reproduce any of the surveys here, but a few excerpts will be given to portray the nature of local price competition. In Exhibit VI there is a price survey from Akron. Out of 590 dealers over 18% were posting prices on their pumps from ½ cent to 1½ cents under the prices of 15½ cents a gallon or 10½ cents ex-tax posted in company stations. Note the number of dealers, including independent Sohio dealers, who were selling at ½ cent to 1 cent under the company price. Since these dealers were paying the dealer price for Akron of 13 cents including tax (8 cents ex-tax), many were operating on a margin of 2 cents and some on less. A letter of the division manager to the home office on July 6 told of two cut-price stations that had been selling at 14½ cents and 14⁴⁄₁₀ cents respectively and had now cut to 13⁹⁄₁₀ cents to meet the competition of one of the American Oil Company dealers (Amoco) shown in the exhibit. In a price survey of July 20 the division manager classified 139 outlets out of the total of 590 as selling at cut prices. How many more concessions there were under prices posted on dealer pumps could not be known. Survey after survey demonstrated that it was impractical to try to establish a service station price that was more than 2½ cents over the dealer price.

EXHIBIT VI

COMPARATIVE GASOLINE PRICES IN AKRON, JUNE 13, 1939

(Sohio posted S. S. price—15.5 cents)

Dealers	Total Number Selling below Sohio Posted Price	Number Selling at		
		15.0 Cents	14.5 Cents	14.0 Cents
Sohio	29	26	3	
Sun	21	14	7	
Gulf	8	5	3	
Texaco	7	3	4	
Shell	8	7	1	
Sinclair	3	2	1	
Amoco	4	2	1	1
Cities Service	2	2		
National	3	2	1	
Phillips	5	2	3	
Pure	2	1	1	
Canfield	4	3	1	
Socony	1	1		
Fleet-Wing	1	..	1	
Pennzoil	1	..	1	
Sterling	2	2		
Atlantic	1	1		
Private brands	5	2	2	1
Total	107	75	30	2

Price surveys for Canton also showed varying prices between outlets. For example, a survey on April 4, 1941, of 64 dealers who had cut prices showed 5 dealers representing 5 different brands selling at 13.4 cents including tax, 28 dealers representing 11 different brands selling at 13.9 cents or 14 cents, 13 dealers representing 6 different brands selling at 14.3 cents, 14.4 cents, 14.5 cents, or 14.6 cents, and 18 dealers representing 8 brands selling at 14.8 cents or 14.9 cents. At the time, the S. S. price in company-operated stations was 15 cents. The company's dealers sold at prices from 13.9 cents up.

Another survey from Toledo showing comparative prices of the company and 28 cut-price or trackage-type firms with 48 outlets is given in Exhibit VII.

The surveys indicate that there are different patterns for price differentials between cut-price brands and the company in different cities.

In Canton, Railway Stores had built a substantial position by selling at 1 cent under the advertised well-known brands. Usually when this outlet cut 1½ cents or 2 cents under other competition, it drew volume so that dealers made price reductions to hold trade and eventually the company had to follow.

Between 1935 and 1936 one company dealer in Canton had sales decline on an average from 8,000 gallons to 2,000 gallons a month, after which he tried his own experiments in pricing. He had asked the company for a reduction in its dealer price, and he claimed he could get a reduction from two major competitors. When his request was not granted, instead of leaving the company, he lowered his own margin by quoting a lower price to customers. At one time his margin went as low as 0.9 cents. His volume went up to over 100,000 gallons a month in one station. And he is still in business and buying gasoline from the company at its regularly quoted dealer prices.

EXHIBIT VII

COMPARATIVE GASOLINE PRICES OF SOHIO AND LEADING PRICE CUTTERS IN TOLEDO

Date	Sohio S. S. Posted Price	Number of Stations Selling at									Total
		Same Price	½ Cent Below	1 Cent Below	1½ Cents Below	2 Cents Below	2½ Cents Below	3 Cents Below	3½ Cents Below	5½ Cents Below	
Before 12/ 1/38....	18.0¢	..	..	..	17	17	..	..	..	9	43
12/ 1/38....	16.0	..	..	31	1	3	..	8	..	..	43
12/15/38....	15.0	5	..	29	10	2	..	..	..	..	46
5/ 5/39....	15.5	..	5	34	5	1	2	..	..	..	47
6/16/39....	16.0	1	1	36	7	1	2	..	..	..	48
10/ 7/39....	16.5	8	1	16	9	6	..	4	4	..	48

Toledo is a city where the normal differential between S. S. prices and cut-price outlets is 1½ cents. In a period of depression, such as 1937, such a differential pulled volume away. It was the opinion of the division manager that early in 1937 this type of outlet was doing about 10% of the business. A year later he estimated that such outlets were doing 20% to 23% of the business in Toledo. In good times, the effect of low prices was less noticeable. For instance, in September 1939 the division submitted a list of 39 trackage stations and 24 dealers of major oil companies that were posting prices below the company. In spite of these facts, volume in company and dealer stations was holding well, and the company was able to ignore the competition. Improving business conditions and personal incomes seemed to result in people being less anxious to capitalize on price and more willing to pay for the combination of convenience and personal service which they apparently wanted.

COMPETITION AND LEADERSHIP

How strong a factor is price competition at the local level? Several market surveys made by three independent research agencies indicate that many customers are attracted to or repelled from Sohio stations or competitive stations selling other well-known brands primarily by the factors of convenience and personal service. Whereas 25% of the people interviewed mentioned of their own accord the importance attached to convenience, and 15% to 20% commented upon personnel or quality of service, rarely did more than 5% refer to price as an important factor in their patronage. It is important to note, however, that in periods of depression a higher percentage of persons mentioned price as a factor; and in 1947, when the level of prices had risen, about 9% mentioned price, which was a substantial increase above usual responses. Moreover, it is only logical to assume that most people's answers to questions of this type understate the importance of the price appeal, since their unconscious reaction is to think of the reasons which make them prefer one station over another when both stations quote the same price. Certainly this seems to be confirmed by the Sohio experience.

The surveys made by the company show that dealers, when seeking patronage in other ways than through outright price reductions, very often used an indirect price appeal. So-called commercial or professional discounts were used by competitive retailers in numerous instances. In Akron in February 1938, for instance, commercial discounts up to 2 cents a gallon were granted to favored customers by competing dealers. In the same month a dealer of a major oil company in Canton was allowing a 3-cent discount to professional people and trucks. Likewise in Springfield commercial discounting was growing in the dealer stations of three major oil companies.

It is well known that competition for commercial business is keen among oil companies, especially when supplies are adequate. Quite often the first signs of a downward trend in a local gasoline market and sometimes in the state market are found by the company in the competitive bids for commercial or public business. When commercial discounts are extended loosely by dealers to retail customers, there tends to be positive evidence of a weak market. Such discounting can develop and remain undetected at first because it is not open and aboveboard. Eventually word gets around among consumers, and those particularly interested in price transfer their patronage. Company volume suffers, and the signals for action become apparent. Because of its policy of one price to all customers buying from a particular station, the company is forced to evaluate the impact of competition on the patronage and profit of its stations.

Another kind of practice in which the company does not engage but which, when adopted by its competitors, sometimes affects company sales volume is the use of premium stamps or coupon books and the giving of free goods with the purchase of gasoline. Springfield and Toledo are two cities in which these practices were extensively used between 1937 and 1941. In Springfield in August 1938 when the Sohio S. S. price was 18 cents with tax (13 cents ex-tax), three stations of one oil company were posting a price of 18½ cents but giving a refund of 1½ cents. Two leading cut-price stations were posting 17 cents and giving a refund when a trading card was filled with stamps. One cut-price station was posting 15½ cents, and another 16⅔ cents with 2 quarts of oil free with a 10-gallon purchase. One cut-price outlet was offering a lemonade set free; another, a pencil free; and still another, a gallon of gasoline free. Fourteen dealers of four major oil companies met the situation with a posted retail price of 16⅔ cents, and one dealer of a major oil company offered a quart of motor oil free with a quantity purchase. Sohio finally met this competition on September 20 by reducing its service station price 2 cents and its dealer price 1 cent.

Add to these facts the detailed results of what happened in three price-cutting situations in three different localities, and it becomes apparent that the company has found price competition strong.

Price War in Springfield. One private-brand dealer apparently "tipped the balance" by a special low-price offering of products for one day only. There had been some rivalry between this independent firm and another independent dealer selling private brands. Both had taken volume away from other dealers, and it appears from entries in the market reports and price surveys that the independent dealers of the Sun Oil Company must have decided to fight these inroads. If Sohio had leadership in the particular market, this experience certainly demonstrates how tenuous it was and how easily it could be taken away by competitors. The company followed the market down. There is significant evidence in this instance that Sohio tried experimentally to lead the market back to more realistic levels.

The detailed story follows: There were two important price-cutting rivals operating in Springfield: Producers Oil Company, a Dayton organization, and the Bonded Oil Company, a local concern. After Bonded Oil opened two stations in Dayton, Producers Oil opened two in Springfield. Producers Oil set up a program to add stations in 1940 and thereafter. On July 22, 1940, Producers advertised the sale of $2.05 worth of products for $1.25. for Saturday only.

A price survey of July 26, 1940, showed that four Sun dealers, one other major dealer, and eighteen private-brand outlets were 1 cent or more under the Sohio S. S. prices. Upon recommendation of the division manager a cut of 1 cent in the S. S. price and ½ cent in the dealer price was authorized.

The price survey of August 5 revealed that Sun dealers again were initiating price reductions, for ten of them were reported as posting prices ½ cent under the most recent Sohio posting. The next day Sohio reduced its S. S. price ½ cent, bringing it down to 9½ cents ex-tax, but it did not change the dealer price with the result that for the first time during the period under review the difference between S. S. and dealer prices was down to 2 cents a gallon.

Sun dealers continued to fight private-brand competition and to take price leadership. The price survey of November 29 showed eleven Sun dealers and one other major outlet at 1 cent under the Sohio S. S. price; seventeen private-brand outlets were 1 cent or more under the company price. Sohio decided to meet this competition on November 29 and reduced its prices 1 cent.

The price survey of December 9 reported that Sun dealers still were leading in price reductions; their prices were 1 cent under the Sohio company price and also below at least six of the private-brand outlets; seven of the latter had followed Sun dealers down to 7½ cents ex-tax at service stations. On December 10, therefore, Sohio reduced its prices 1 cent to meet this competition.

This price war made the *Springfield News* on December 12 and 14. Sun dealers and some of the private-brand outlets nevertheless cut prices another ½ cent under the company; on December 16 the company reduced its S. S. price ½ cent to 7 cents ex-tax, the lowest price of the eleven-year period under review. The dealer price was 5 cents a gallon. Company files do not show whether Sun dealers made any more reductions, but it may be presumed that they did not.

By this time it must have been evident that the Sun dealers would meet competition. Their influence on volume was great enough to cause Sohio to follow. On the other hand, Sohio at the first reasonable opportunity wanted to establish a level for the market which both fairly represented supply and demand conditions for gasoline and would allow for the retail costs of the more efficient firms. Sohio could only find this level by experimentation, for its own costs were not necessarily the same as those of other oil companies or of independent retailers of gasoline.

On January 1, 1941, the company took the initiative in an attempt to establish a higher price structure in Springfield by raising prices 1½ cents. But on January 3 when the Sun dealers raised their prices 1 cent to a level ½ cent below the company service station price, Sohio immediately reduced its S. S. price ½ cent to 8 cents ex-tax. On January 9 upon the Sun company's reduction of ¼ cent in its dealer price, Sohio reduced its S. S. price ¼ cent to 7¾ cents and dealer price to 5¾ cents.

The experimental character of price advances after a price war is suggested by the following facts. The division manager stated in March 1941 that the low level of Springfield prices was draining patronage from outlets in Clark, Champaign, and Green Counties, and he recommended a ¾-cent advance in both S. S. and dealer prices, which was placed in effect on March 11. On April 2 Sohio raised the S. S. price 8⁄10 cent and the dealer price ½ cent. On April 24 Sohio found it possible to raise its dealer price another ½ cent and its S. S. price 7⁄10 cent. On May 6 both prices were raised ½ cent to make an S. S. price ex-tax of 10½ cents. The price survey of May 20 indicated that most major outlets and Sohio dealers were following the prices up and that private-brand outlets were predominantly ½ cent under the company. On May 20 the dealer price was reduced 2⁄10 cent to bring the spread between dealer and S. S. prices up to 2 7⁄10 cents and thus meet the effect of Shell's refund to dealers of 2⁄10 cent for the months of April and May.

Canton Price Wars. The following incidents from Canton illustrate some of the practical problems facing the company that grow out of the fact that it is both a jobber and a retailer. Since Sohio is one of the large marketers in the area, its posted prices on pumps in company-operated stations tend to set an upper limit on the prices which competing dealers buying from any source can charge for gasoline. Since the company also needs the distribution service of independent dealers, it must assume a responsible attitude toward their success or failure. The company is thus caught in a real predicament: Will it try to impose a level of service station prices on the market through its quotation of the service station price applicable to its own stations and thus try to protect dealers? Or will it let the market define that level?

The evidence from Canton, which the author found duplicated in other cities, indicates that if enough dealers want to work on a low margin, the company cannot prevent their doing so, even if it so desires. As a matter of fact, it is contrary to company policy to interfere in any way with the pricing or other operational policies of its dealers. Moreover, if the company sets a price in its stations that is higher than the market, it loses volume. It has little choice except to follow the market. In this particular locality, the company twice tried to lead the market up, in order to increase the return from its own stations and in order to fulfill its responsibility to dealers, and failed each time.

Early in 1939 the company had reduced its S. S. price in Canton to 10 cents ex-tax; the price to dealers was 7½ cents. This move had been made to narrow the spread between company outlets and leading private-brand outlets, such as Railway Stores, Spur, and other price cutters. During May the company decided to experiment with some price increases. On the 5th it raised both its S. S. and dealer prices ½ cent, and on the 9th it increased the S. S. price ½ cent bringing it up to 11 cents. On both the 22nd and the 25th the home office received letters citing losses of gallonage as a result of these increases. On the 27th, to protect its sales, the company met the competitive situation by reducing the S. S. price 1 cent and the dealer price ¼ cent. Any dealer who paid company prices for his supplies and sold at S. S. prices thus only had a margin of 2¼ cents. This spread was so unattractive to dealers that on June 2 the company reduced the dealer price ¼ cent.

On June 9, 1939, the Canton Division reported that price cutting was still going on in the market. On June 21 the Fair Deal Gas Stations ran an advertisement in which they asked: "Is the small businessman being spanked?" The company believed it had no initiating responsibility for the plight of the "small" businessmen, since its moves had been made in response to market facts; nevertheless it promptly gave dealers another chance to set a higher level of prices. The company raised its S. S. price to 11 cents ex-tax, thus providing a 3-cent spread between the two prices. But this change was not destined to last long. A letter of July 18 reported the breaking down of dealer prices. Blue Sunoco, for instance, was being sold at 14 cents retail or 9 cents ex-tax against the company price of 11 cents ex-tax. Numerous other letters of August 14, 18, and 25 revealed that the company was being widely undersold. The company met the situation directly on August 26 when it reduced its S. S. price to 9½ cents ex-tax and the dealer price to 7½ cents. During June, July, and early August the company had suffered a steady downward trend in sales at company-operated stations. The August 26 price reduction brought about a sharp reversal in trend, which was well maintained until December.

In the fall of 1939, on the basis of general strength in gasoline markets, the Canton S. S. price was raised ½ cent to 10 cents ex-tax on October 7; the Canton S. S. price was still 3 cents under Cleveland and 2 cents under many of the larger cities of the state. The dealer price was reduced ½ cent on October 11, thus restoring a spread of 2½ cents between dealer and S. S. prices. The price report of October 30 showed that 29 stations carrying the brands of major oil companies or private brands were underselling the posted prices by ½ cent to 1½ cents. Nevertheless, no action was taken as sales at company-operated stations had not shown a serious decline.

The situation in the first half of 1940 illustrates the mixed pressures on prices from dealers and suppliers. It was company policy to assess separately the economic forces at work in the retail market and the jobber market and to adjust its service station price and its dealer price accordingly. As the following detail shows, it is not always easy to identify which forces are which. Some experimentation in pricing is frequently necessary to clarify this question and to find out how the markets will react.

During the first quarter of 1940 signs of weakness in the retail prices of gasoline appeared. A division letter of January 10 described the activities of distributors who operated their own stations and hauled gasoline from the bulk plants of their suppliers. They were buying at or near tank car prices, thus giving them a basis for real price advantages in the competitive retail battle. A price survey of February 23, 1940, containing 37 photographs, showed 32 major-brand and 5 private-brand outlets underselling the company from ½ cent to 2½ cents. The division manager estimated that 30% of Canton volume was being posted below the Sohio price. On February 29 a photograph was submitted which showed Red Head gasoline posted in Railway Stores stations at the equivalent of 8½ cents ex-tax against 10 cents ex-tax for Sohio. This spread was considered significant because Railway Stores had built its business on a 1-cent differential. On March 1 Sohio cut its prices ½ cent, thereby reducing the spread between it and Railway Stores to 1 cent. Company sales took a temporary spurt upwards, but this gain was soon lost as a result of continued price cutting. On May 15, therefore, the company reduced the S. S. price 1 cent and the dealer price ½ cent. The 2-cent spread thus established continued for nearly a year thereafter.

Pricing Strategy in Toledo. The city of Toledo provides us with examples of the dynamic character of pricing problems and the consequent necessity for an experimental attitude toward market realities. Following a period of low prices in Toledo in 1938, the company decided in 1939 to try raising prices. Its strategy was to post one small advance and, when it was followed, to announce another, and thus gradually to increase its return in Toledo. It had some success with this approach as the following facts show, but it did not succeed in getting the city up to the state-wide price level. The reader should note how company price action was affected by variations in its sales volume. It ignored price competition when its sales were maintained.

The company tried three price advances in Toledo in 1939. The first of ½ cent in S. S. and dealer prices occurred on May 5, when the three cut-price cities of Akron, Canton, and Springfield were also raised ½ cent; the state-wide price at this time was reduced ½ cent. Toledo was 2 cents under the state-wide price. The May 11 letter on price conditions received from the division stated that most competitors increased their prices ½ cent. Some remained at the old price, however, and it was thought they might become the cause of a future general breakdown of prices. The second advance of ½ cent in both prices was made effective June 16. On June 19 the division stated that most competitors had followed this advance with the outstanding exception of Sears, Roebuck and Co. By June 23 eight Sun Oil stations were posting prices under the company. Letters of July 6 and July 10 nevertheless reported June sales as satisfactory.

On July 26 a letter from the division manager listed 52 stations whose prices were from ½ cent to 1½ cents under the company's; these included the usual trackside list and dealer outlets of Sun, Sinclair, Hi-Speed, Gulf, Shell, and National Refining. Eleven of the stations were using coupon books or premiums in addition to price appeals to attract patronage. Letters of August 4, 18, and 23 described a further breakdown in prices in Toledo.

On September 28, 1939, the division submitted a list and supporting photographs of 39 trackage stations and 24 dealers of major oil companies that were posting prices below the company. In spite of all the evidence of price cutting in particular competitive stations, the volume of the company was holding sufficiently well for the management to ignore the competition.

As a result of the evidently strong underlying factors, the company made a third price advance of ½ cent on October 7 in connection with a state-wide advance of similar amount. Toledo was then only 1½ cents under the state-wide price. The spread between dealer and S. S. prices continued at 3 cents. On October 11 the division reported that most stations of competitors had advanced their prices ½ cent though some 32 in the area were selling at the old prices.

The uncertainty of results to be anticipated from price moves may be demonstrated by using the experience of 1940 in Toledo.

On May 20 the division manager submitted five pictures of cut-price stations that had reduced prices. Three days later he sent in pictures of two more such stations and recommended a reduction at 1 cent in service station prices at two key company stations. He said, "I feel this move is essential if we are to hold our gallonage at our servicenters, and we may have to make the same move in other parts of town to protect our gallonage." His recommendation was approved. The company did not wish these prices to be depressed, and so four days later it tried an increase of ½ cent. Several days thereafter it raised them another ½ cent back to the regular posted S. S. price for Toledo. However, the company was unable to maintain this price, for price competition became widespread, and on June 13 the company followed the market down; S. S. prices were reduced 1 cent and dealer prices, ½ cent.

Dealers in Toledo had never suffered long periods of very low margins, and this fact had some bearing on the strategy back of the next three price moves. The company, moreover, did not desire such a low margin—one that did not cover its own costs and those of most of its dealers. The real problem was to find out whether higher prices and margins would be followed. An increase of ½ cent on July 9 in S. S. and dealer prices held sufficiently well to encourage the company on July 12 to try another 1-cent increase in the S. S. price and a ½-cent increase in the dealer price. This brought the spread between dealer and S. S. prices to 2½ cents, and the S. S. price ex-tax to 10 cents. These prices and spreads were maintained until April 1941.

DEALER MARGINS

The company has an obvious interest in the width of the dealer margin in its market. As noted earlier, it does not post a dealer margin as such, though for the purpose of the immediate discussion, as was explained, the author has regarded the spread between the two posted prices as a "posted" dealer margin. In this sense, the company's state-wide posted prices have allowed a uniform dealer margin for many years, since from 1937 to 1946 the posted service station price was always 3½ cents higher than its posted dealer price. On November 28, 1946, the company announced a state-wide margin of 3¾ cents, but this figure did not for some time become the actual margin in any of the 14 key cities (see Exhibit VIII).

EXHIBIT VIII

SOHIO "POSTED" DEALER MARGINS IN KEY CITIES—1936–1948

Year *	Number of Cities Selling at Margins of					
	4 Cents	3.5 Cents	3 Cents	2.7–2.8 Cents	2.5 Cents	2 Cents
1936	..	14				
1937	..	14				
1938	..	13	1			
1939	..	2	11	..	1	
1940	..	..	9	..	2	3
1941	..	..	6	4	4	
1942	..	..	11	..	3	
1943	..	..	12	..	2	
1944	..	..	14			
1945	..	..	14			
1946	..	..	14			
1947	..	14				
1948	14					

* As of July 1, 1936, to July 1, 1947; January 1, 1948.

Note: The key cities are: Akron, Canton, Cincinnati, Cleveland, Columbus, Dayton, Lima, Mansfield, Marion, Portsmouth, Springfield, Toledo, Youngstown, and Zanesville.

By July 1947 the 3¾-cent margin became generally applicable. Late in 1947 the "posted" dealer margin was raised to 4 cents in order to cover the higher wage costs of dealers and company-operated stations.

Thus, in effect, with the "posted" dealer margin actually being realized in 1946, 1947, and 1948, the increase was from 3 cents to 4 cents, or a gain for the dealers of 33⅓%. Even at 4 cents in 1947 the margin prevalent in Ohio was lower than that taken by dealers operating under the so-called Iowa plan (whereby company-owned stations are leased to dealers) in a number of other states—a point of some significance as will be evident later.

A further complication is the fact that at certain times during the period reviewed some suppliers gave guaranteed margins to dealers. In effect they guaranteed that their own dealer prices would always be a certain figure under the service station price of Sohio. This was not necessarily the phraseology of any contract, but it was the intent. In 1937 in Akron, when the spread of prices was 3 cents, two dealers were lost to a competitive supplier who the dealers claimed had offered them guaranteed margins of 4½ cents. In 1938 competitors were reported to be offering margins of 3½ cents and 4 cents when the company spread was 2½ cents or 3 cents.

The policy of the company with respect to the spread between S. S. and dealer prices is (1) to follow the retail competitive market in quoting a service station price and (2) to quote a dealer price that measures the competitive forces at work in the jobber or supplier market. Certain economic factors, such an as oversupply of gasoline, will generally react on all prices. In such cases dealer and service station prices tend to move together. On the other hand, other economic factors such as overdevelopment of retail outlets in any particular area or the price behavior of dealers may affect a single price only, in this case the retail service station price, with the retail and dealer prices tending to move independently of each other. Markets, not company costs, make both these prices.

At the same time, the company of course must take costs into consideration. The independent dealers who are Sohio customers want their margin to cover their costs, and the company expects in the long run to conduct its operations so that the prices in company service stations will be high enough to cover the costs of handling gasoline from the refinery through the service stations. The aggregate income in both company and dealer stations is affected by price-volume relationships and the sales of other services. The total costs, too, vary with volume because of the elements of fixed and variable expense.

The company knows its income and costs in its stations, and it carries on experimentation to find the combination of price, volume, services, and facilities which will maximize net income. But the expenses incurred in company stations are not exactly comparable with those of independent dealers. On the one hand, many of the dealer units, because of their small size, do not incur some of the Social Security costs which the company must absorb; individual proprietors are exempt from the provisions of wage and hour laws; the pressure on independent dealers to pay union rates of wages is not so great as it is in any responsible large company, whether in this industry or some other. Moreover, many of the independent stations operate gasoline pumps as a sideline to some other business, which carries most of the overhead. On the other hand, as an offset against certain higher costs which the company may incur in its stations are the lower costs of servicing these stations in the jobber part of the company operation.

Thus the economics of dealer operation are obviously quite different from those of the service stations of a semi-integrated company like Sohio. Yet the fact that the company must depend upon independent dealers means that it cannot establish prices in its own stations which might make it difficult or impossible to obtain the desired services of independents. The company therefore is interested in the ability of its customers to survive under conditions of retail price cutting and low margins, even though imposed by the market rather than initiated by Sohio.

This concern about dealer margins is reflected in a research study made in November 1941 of the comparative position of several types of dealers between 1937 and 1940–1941. Exhibit IX contains a summary of this study. Four groups of service station dealers were included. Groups I and II had no physical improvements made in their stations between 1937 and 1941; in Group I margins realized had been reduced from 3½ cents to 3 cents, and in Group II from 3½ cents to 2½ cents. Groups III and IV had enclosed lubricating facilities added between 1937 and 1941; in Group III margins realized were reduced from 3½ cents to 3 cents as in Group I, and in Group IV from 3½ cents to 2½ cents as in Group II. All stations in these categories in 1937 were covered by the study.

EXHIBIT IX

EFFECT OF MARGIN REDUCTIONS AND IMPROVED FACILITIES ON NET TO SOHIO DEALERS

	Exposed Lubricating Facilities				Enclosed Lubricating Facilities Added			
	Group I (69 Dealers)		Group II (87 Dealers)		Group III (23 Dealers)		Group IV (31 Dealers)	
	1937	1941	1937	1941	1937	1941	1937	1941
Gasoline margin	3.5¢	3.0¢	3.5¢	2.5¢	3.5¢	3.0¢	3.5¢	2.5¢
Average monthly gallons per station	8,059	8,786	8,806	11,459	9,645	12,822	9,894	15,069
Percentage change in gallons per month *	....	+9%	....	+30%	....	+33%	....	+52%
Average monthly gasoline margin	$281.86	$268.66	$312.16	$298.20	$337.56	$392.15	$349.29	$388.93
Percentage change in gasoline margin	....	−4.7%	....	−4.7%	....	+16%	....	+11%
Other merchandise and services margin	$ 73.38	$135.61	$121.25	$201.51	$120.04	$301.66	$136.10	$358.00
Percentage change in margin—merchandise and services	....	+85%	....	+66%	....	+151%	....	+163%
Total income	$355.24	$404.27	$433.41	$499.71	$457.60	$693.81	$485.39	$746.93
Rent	$ 77.76	$ 72.58	$102 84	$ 89.31	$ 91.24	$128.59	$107.34	$126.01
Labor	66.13	83.38	105.18	131.17	112.11	194.02	111.24	205.24
Other expenses	28.17	33.50	35.70	44.59	33.69	63.29	37.87	86.38
Total expenses	$172.06	$189.46	$243.72	$265.07	$237.04	$385.90	$256.45	$417.63
Net for dealer-operator	$183.18	$214.81	$189.69	$234.64	$220.56	$307.91	$228.94	$329.30
Percentage change in net to dealer	....	+18%	....	+24%	....	+40%	....	+44%

* State taxable consumption gained 14% between the two periods.

With the exception of the first group, all groups increased their gallonage sales over the period more than the increase in total state consumption. In the first two groups there was a decline in the dollar gasoline margin, and in the other two groups an increase. In all cases the associated sales of merchandise increased greatly, so that after the deduction of expenses the net available for the salary and return on investment of the dealer-operator actually increased. The advantage of improved facilities seems to be obvious. It is particularly notable, also, that both the aggregate and percentage increase in the net for the dealer was greater when the margins were smaller.

There is every indication that the demand for gasoline as a whole is not so elastic as the demand at particular stations. Reduced prices may result in the transfer of patronage without appreciable increases in total gasoline sales. The number of dealers in Ohio did not increase so rapidly as in many other states. The low-margin policy may have contributed to this situation.

Sohio policy is one of nonresistance to underlying economic forces. On the other hand, the company hesitates to expedite these trends. It prefers to follow rather than to lead. This seems to be good judgment. While social and economic changes are desirable, it is better to have them evolutionary and moderate than revolutionary and unduly accelerated. Furthermore, any company that reads the decisions of the Federal Trade Commission as supported by the courts and reads debates in Congress and state legislatures can appreciate that economic efficiency is not the sole test applied by our public policy makers to business practices. The chain grocery stores, for example, have found this to be true. It would be foolish for Sohio not to take the social environment into account.

Political Aspects. To an outsider one of the interesting aspects of pricing policy is its relationship to outside agencies and the public. The situation in Akron after the end of the NRA is a case in point. The division manager in Akron was the source of the following information.

In October 1934 the spread between dealer and S. S. prices was 3½ cents, where it remained until 1937. In the spring of 1936, an organization of dealers in Summit County held a meeting at which the members apparently agreed to raise the service station prices ½ cent to provide dealers with a 4-cent margin. Just before the middle of July 1936 the company received a letter from this association stating that on July 15 its members were going to post prices representing a 4-cent margin and would appreciate the cooperation of the company. In reply the division manager pointed out that there were already many posted prices below the 3½-cent level, indicating an existing softness in the market which would only be exaggerated by a higher posting. The company did not increase its service station price, and company stations were blockaded by certain of the dealers and their sympathizers about the 16th of the month. The company was informed that the blockade would be withdrawn if it removed its price signs from in front of the stations. The company did not acquiesce; the blockade lasted from 10 to 15 days with diminishing success; and the 4-cent margin posting of the dealers gradually weakened.

In a pithy talk to a meeting of the company's marketing department in September 1937, the division manager commented upon the relations with the dealers' association in Akron and price differentials, as quoted below. Of particular interest is the way the Iowa plan of leasing stations to dealers, which actually had been started to meet the threat of sharply graduated taxes on multiple outlets operated by a single company, struck one of the men "on the firing line" in this quite different situation.

> To say truthfully whether the Iowa plan was the father of the mark-up or the mark-up was the father of the Iowa plan would be largely a matter of geography. Having found themselves on their own in Iowa, it didn't take the boys long to hit upon the idea so generally advertised by the NRA that if you needed more money, the consumer stood ready if not glad to give it to you. Then as the mark-up idea spread, companies which would rather die than to say "no" found the leasing of stations a perfect solution of a double problem, that of retaining dealers' good will and in most cases sidestepping a retailing cost which had already become burdensome. This flight from trouble was by no means confined to Ohio. Today enormous areas, both metropolitan and rural, are represented by no salary-operated [company-operated] stations owned by major companies. In fact, during this transition, Ohio is probably the most significant area in the country for one particular reason. That is that in the face of terrific pressure this company has retained out of 797 stations, 127 servicenters and 113 regular stations, or 240 in all on a salary basis and that so far as these stations dominate their areas, they establish a 3½-cent margin for resellers. This change occurred first in Akron in July, 1936, and if our experience is any standard for other divisions, the history is about like this: that for the first month or two the main job is to dodge the bullets. After that both the dealers and the Company settled down to live together and like it. This first period was particularly embarrassing for us because we had made almost no progress in signing dealers on a lease and sublease arrangement when the battle was begun, and we were naturally pretty nervous about such a thing as a dealer boycott. It is therefore important to record that in the thirteen months that we have now lived with this situation, we have never lost a dealer because of this difference in point of view.
>
> This new situation has produced certain results which ought to be put in the record. I suppose nearly all of you are now living with a price situation of Standard Oil Company service station price of 19 cents; Dealers' Association price of 19½ cents; and trackage-station prices of 17½ cents. Such a situation cannot help but be a great advantage to our company-operated stations and to the trackage stations. Which of these will gain the most will depend on which has the better representation to pick up the volume so energetically thrown away by the dealers using the mark-up. However, a shift of volume has set in and seems to be gaining in momentum. A year ago I mentioned that I did not like the Iowa plan. Today I do, provided our competitors go to it and we don't. . . .
>
> Now please get this and get it straight: The refusal of this company to follow along with a 4-cent margin is not political. God knows we were driving right into the face of apparent good politics by *refusing* to follow. Therefore if we are not correct in our position or our diagnosis, we must pay a heavy penalty because we went counter to about 90% of the dealers' desires in this matter and counter to 100% of our competitive propaganda.
>
> Today in Akron where this situation has been longest established and where therefore the forces set in motion by the dealers' mark-up have had the longest time to ripen, the issue has been forced, not by us but by the cut-price marketers.
>
> I shall not dwell upon the troubles incident to a growing cut-price market, except to point out that when all the protection possible has been given by suppliers it still is a field day for the cut-price boys when the dealers give them 4 cents to work on. Today in Akron we are supplying dealers at 14½ cents. The trackside are selling at 16½ cents and the dealers are attempting to get 18½ cents. I need hardly point out that we could supply the cut-price people at our prevailing tank wagon price and they would still find it profitable to undersell. Therefore this advantage must be met out of dealers' margin because only there can the *relative* prices be brought nearer together. Today a feeble but significant movement has been started in Akron

to reduce the dealers' margin to 3 cents. In the meantime we have enjoyed a comparative immunity by occupying a middle ground by giving our salaried operation the benefit of a ½ cent mark-down from the Dealers' Association price. We have been admitting for years that too many outlets were being established, that the little veneer of profit was being spread too thin to support the number of people seeking a livelihood behind the gasoline pump. Now if a day of reckoning is at hand, for God's sake, let us not bury our heads in the sand and try to postpone it.

FURTHER CONSIDERATIONS

This case study is not complete without a comparison of Ohio gasoline prices with those in other states and cities and a glance at the upward trend of prices in the postwar period.

Comparison with Other Markets. In 13 Ohio cities Sohio dealer prices ex-tax were 0.57 cent a gallon higher than prices in 12 border cities in 1936, and 0.05 cent higher in 1937. In 1938 they were 0.14 cent lower. Between 1939 and 1947 Sohio prices averaged from 0.5 cent to 0.7 cent lower. Since November 1947 Sohio dealer prices have averaged slightly over 0.2 cent higher than the border cities.

These facts seem to coincide with the basic economics of the Ohio market. It is one of the denser gasoline markets of the United States, and therefore jobber costs tend to be lower. It is available to many refinery areas and is a convenient place to dispose of surplus gasoline. Few companies like to "spoil their own markets," but they have no compunction about spoiling the other fellow's market. Thus Sohio, whose basic policy is to take an economic reading of the market and post a price accordingly, would be expected to post relatively low prices. Moreover, its desire for some stability in prices could not be realized unless it stabilized at realistic levels.

So far as retail prices to consumers are concerned, from 1937 on the Sohio state-wide posted S. S. price ex-tax averaged 0.51 cent under similar prices in 50 United States cities. In 1938, Sohio was 0.83 cent under; in 1940 and 1941, 0.18 cent under; from 1942 to 1945, about 1 cent under; and in 1946 and 1947 about 0.7 cent under. When realized S. S. prices are compared to posted prices in other cities, Sohio in some years was 2 cents under the 50 cities and for the 11-year period averaged 1.63 cents under the 50 cities. Of course the statistics probably do not tell the whole story, for there must have been concessions under postings in comparable periods in other marketing areas, of which this company has no measure. Yet, caution about making a claim for the precise amount of the difference does not alter the fact that the price policy of Sohio and the margin policy set by dealers made for relatively low prices in Ohio.

Since 1946, with gasoline supplies tight, the company has of course been able to charge more, in accordance with its policy of obtaining all it can consistent with its long-run objectives. But the fact remains that prices have still been low relative to other market areas. A higher price in Ohio, under current conditions, might attract enough marginal suppliers into the market to meet demand. It is significant that during 1947 the company allocated gasoline among its customers and actually closed its company-operated stations for whole days or parts of days on account of shortages, which suggests that it could have obtained higher retail prices if it wanted to. In accordance with its longer view of its activities and its sense of public responsibility, it did not elect to exploit customers and charge all the traffic would bear. In other words, it did not let price be the device for equating demand and supply. The management probably would not entirely agree with the above description; it would simply emphasize its conscious policy that low prices are sounder than high prices in the long run and would attribute the oasis of low prices in Ohio in part to that company policy.

Postwar Gasoline Prices. Postwar gasoline prices are largely the function of phenomenal increases in demand for petroleum products, reflected in higher crude oil prices, and a large dosage of common sense by price leaders who are trying to keep demand pressures from causing greater increases in prices.

The petroleum industry had anticipated some decline in total demand for products following the war. It was not thought that consumer demand for automobile gasoline, fuel oil, industrial fuels, lubricants, and so on would replace the tremendous war demand as promptly as it did. But peacetime demand increased beyond war demand. By the middle of 1946 the premiums being paid by some purchasers of crude forced the market price up. When an oil purchaser loses many well connections and a substantial volume of oil because someone else will pay more for the oil, the price of crude oil is most likely to advance.

There is not space here to discuss the arguments that took place in the industry about the wisdom of trying to hold the price of crude oil down "because higher prices would not produce more oil" in view of shortages in drilling supplies, equipment, and pipe. The valiant efforts of some of the crude price leaders to hold the price down were not wholly successful. However, the public expression of opposition by different oil companies to advances in crude did, in the author's opinion, keep the price from going still higher. It is a fact, although the general public is not likely to realize it, that some of the higher 1947 and 1948 profits of oil companies which are producers of crude oil have come as a result of higher crude prices forced upon them by market demand. Sohio, of course, is a net buyer of crude; and since crude is a substantial cost to Sohio, it raised its gasoline prices.

While price advances reflected the increase in product demand, apparently the retail price was not used to equate demand and supply. Rather, allocations and public campaigns to conserve products and to reduce consumption were resorted to. In some states public officials supervised allocations. In September 1947 the author watched an operating committee of Sohio make decisions to give up profitable gasoline sales through its company-operated stations for less profitable sales to other customers: the decisions were difficult to make, but they seemed to be the only justifiable ones in terms of long-run obligations to customers.

The fact that the economics of the oil industry allow many companies to carry their distribution function down through jobbing and sometimes through retailing probably has been an advantage to the public, for it has prevented black or grey markets on a large scale. In contrast there have been grey markets and high prices in steel products and high prices based on demand and supply factors in used-car lots. But manufacturers of steel and automobiles who are also regarded as monopolistic competitors by certain economists are not taking full advantage of the situation. Some jobbers and some small oil companies have sold at higher prices. This enables the latter among others to pay premiums for oil with the consequences already noted.

SUMMARY AND CONCLUSION

What does the above description of the pricing of gasoline by a so-called price leader add up to? As a semi-integrated company, selling to dealers as a jobber and to consumers as a retailer, Sohio has two separate markets to appraise. Economic forces in these markets to a considerable degree are focused on local areas. Local retail dealers set the different patterns which the company has to meet as a retailer. Local, almost pin-point, price cutting and other indirect forms of competition of suppliers in local areas have caused the company to make variations in its dealer prices also on a local basis. Recognition of these realities has finally resulted in the abandonment of a state-wide price.

On the question of price leadership in the jobber market, there is no doubt that the company can post a price; whether it is followed by others is another question. As a large marketer the company can attempt to lead prices up, but its success depends upon having followers. Any of the other marketers in the state, by refusing to follow, can force the company to reconsider its action as was done once on a state-wide basis and in many instances on a local basis. They can draw enough volume away by retaining lower prices to induce the company to retrace its steps. In turn it would be difficult for smaller marketers to lead prices up if the company did not choose to follow them.

The company can and does lead the jobber market down when there are substantial reductions in crude, although there was only one example during the period studied because of the general rising trend of prices. At the same time, other oil companies or jobbers, through direct price reductions or indirect measures, frequently have taken the actual initiative in leading local prices down, when it was to their advantage. After many occurrences of this kind, Sohio reduced its state-wide prices, thus giving the appearance of having led the market both up and down. This is a superficial view of the real situation, largely caused by the fiction of a state-wide posted price.

In the retail market the company is more aptly described as a follower than as a leader. While it does quote a retail service station price at a varying figure above its dealer price, it cannot make others follow this price. It does not believe in asking its own dealers to follow, and many do not. Company dealers of course are in competition with other dealers in the local area. The market forces set an upper limit on the prices which all these dealers can charge in the long run. Temporarily, one may charge more than the others, but he will liquidate his position unless he has some special service or location appeal for customers. Thus, the company cannot state a price which is far above the levels which other dealers charge.

True, the many price surveys made by the company show that it often was somewhat above its retail competitors but maintained its sales through the quality of service rendered in its particular locations. The price differential which consumers will pay for these features, however, is definitely limited and varies between local markets. Neither the company nor the author has worked out any scientific rationale as to why these differentials vary. The necessity of responding to the facts is more important than the reason why. These very differences generate efforts to reduce costs by improvements in methods of transportation and the like. The alert marketer is ever on the watch to hold his volume position and to discover ways of improving his profit position. It is this competition for advantage that brings about the types of service, products, and location for which consumers are willing to pay.

The result of accepting economic fact and following the market in naming its retail price is that the spread between S. S. and dealer prices is not so excessive as to lead to overexpansion of outlets. Nor is it so large as to be described as a "high-price" policy, which the history shows induces price cutting and wasteful forms of competition. The margins seem adequate for efficient dealers. The company appears to be operating on the assumption that when retailers are allowed to establish the level of retail prices and thereby their margins, the company receives less onus for the result than it would if it had taken the leadership directly. What a man does to himself, or what a group of men of kindred spirit do to him, he may accept gracefully, whereas a similar thing done by a large company or a price leader he is likely to reject with feeling and even with public clamor. Price leaders can ill afford to neglect human nature or the social environment in which they operate.

The company has demonstrated that it does not want to drive firms out of business unfairly, but neither can it or will it hold an umbrella over the market by a high-price policy. The latter was tried years ago and failed. The present management is against such unrealistic policies.

Sohio does not use a formula in establishing either of its prices. It has neither a single nor a multiple basing point system. No one factor seems to be dominant in its judgments as to what prices ought to be. Its management believes that markets, not refineries or individual consumers, make prices, and there certainly is a large quantity of evidence in the Sohio price history to support this view.

Is it not refreshing to have a business firm admit that it wants to get as much for its products *as is consistent with its long-run objectives for survival and reasonable stability?* Is it not human for the executives to say, in effect: we do not like to spoil a market, but in fact we could not prevent price competition and indirect competition for advantage if we wanted to. If our judgments of economic reality are correct, market prices will be followed; if we are wrong, we will have to change our prices or lose our place in the market.

By tests which the public may well apply to so-called monopolistic competitive industries, the gasoline market in Ohio during 1937–1947 was a socially sound one. Consumers had a chance to choose between stations combining varying elements of price, service, quality, and dependability. There was freedom for new firms to enter the trade and for new or old firms to try new combinations of functions at the various stages from production of crude oil to ultimate sale of gasoline. Innovation was not suppressed. New methods of performing or combining old functions of distribution developed. The market was filled with dynamic forces with which the so-called price leader had to cope. Is it any wonder that management believes that leadership in the sense of any real control to do what it pleases is a fiction?

Of course Sohio, like other individual oil companies, does have some control over its prices. This kind of control seems to have prevented gasoline prices from spiraling as much as many so-called free prices. Administrative price making in contrast to impersonal market price making was roundly damned by some writers in the early 1930's, and sometimes correctly. Yet what would prices be today in the oil industry, and in other industries as well, if there were not some administrative price makers who realized that they had public as well as stockholder responsibilities for prices? And does not the evidence indicate that in Ohio it is impracticable to administer prices at anything except competitive levels; that it is impossible to hold prices up by administration? Competition among dealers and competition among suppliers for increment profits are such strong market forces that they cannot be resisted.

In any event, there is no point here in trying to defend all administratively determined prices. But the worst that can be said is that even the devil is entitled to his due. And the price makers in the Standard Oil Company (Ohio) can hardly be regarded as devils. They are sincere, responsible businessmen dealing with many difficult, complex, and often intangible problems. By their attitude, such men must be judged. They are not perfect in their judgments, but they are trying to do an honest job which can be reported unashamedly to the public. They are not alone in the oil industry or in American industry in this respect. If more companies would tell their true pricing story, then all of us—economists and others—would have a better base upon which to do our theorizing.

RESALE PRICE MAINTENANCE

ORIGIN OF THE STUDY

This report was made in response to a resolution of the Federal Trade Commission under authority of the powers vested in the Commission under Section 6(*a*) and (*b*) of the Federal Trade Commission Act.

Prior to the signing by the President on August 17, 1937, of the District appropriation bill, to which the Tydings-Miller amendment to the Federal anti-trust law had been attached as a rider, decisions in a number of cases under the Sherman law and the Federal Trade Commission Act made it clear that where a manufacturer maintained the retail price of his patented, copyrighted, trade-

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Source: Excerpts from the *Report of the Federal Trade Commission on Resale Price Maintenance* (Washington, D.C., U.S. Government Printing Office, 1945), Summary and Conclusions, pp. xxvi–lxiv.

marked or otherwise identified goods by restrictions marked on the goods or otherwise communicated to the retailer, a violation of these restrictions did not create a cause of action in favor of the manufacturer either under the common law or under the patent or copyright laws, and that where a manufacturer maintained the resale prices of his identified goods by a system of contracts or equivalent cooperative methods, those contracts were void, and such methods illegal under the Sherman law and the Federal Trade Commission Act.

The Tydings-Miller Act amended the Sherman Act to the extent of legalizing minimum resale price maintenance agreements or contracts respecting trade-marked or otherwise identified goods sold in interstate commerce provided that the commodities affected were resold in any State that had legalized this type of contract or agreement with respect to resales made within its boundaries. The act contains a specific prohibition against horizontal agreements. It also amended the Federal Trade Commission Act by providing that the making of such contracts should not constitute an unfair method of competition under Section 5 of the Federal Trade Commission Act.

It is to be borne in mind, however, that the Tydings-Miller Act is not designed to prevent unfair practices, such as selling below cost for an ulterior purpose. It is designed to enable the manufacturer to arbitrarily impose and maintain minimum prices at levels fixed without relation to differences in cost among different distributors and dealers.

NATURE OF RESALE PRICE MAINTENANCE

Resale price maintenance as now practiced in intrastate commerce in 45 States of the United States, and in interstate commerce with those States, is a system of pricing a trade-marked, branded or otherwise identified product for resale in which, pursuant to laws legalizing such arrangements, the manufacturer, producer or brand owner, or his authorized agent, factor or wholesale distributor, prescribes by contract the minimum price or the resale price at which such product may be sold at wholesale, and the producer or manufacturer and his factors or wholesalers prescribe the minimum price or the resale price at which such a product may be sold at retail, in a specified State, or in a specified portion thereof, with the effect of legally binding all other distributors in the specified area to conform to such prices. This is done by entering into contract with at least one such distributor of such product and serving notice upon all other distributors who are thereupon obligated to maintain the minimum price or the resale price named in the contract. In some cases, wholesale distributors, acting without the authorization of the manufacturer or brand owner, have entered into contracts with retailers for the maintenance of retail prices.

The significance of the resale price movement cannot be properly interpreted without taking into consideration its fundamental origin, namely, that it was the manufacturers who were in the vanguard in advocating and using it on the ground that they had a proprietary interest in goods carrying their trade name or brand. Later, with the development of the department store, the consumer cooperative, the chain store and last of all, the super market or "giant store" types of distribution, the older types of merchandisers who progressively lost business to each new type of distributor that developed turned to manufacturers, demanding price protection. Since about 1920, the development of new types of distributors has been rapid and the leadership in the resale price maintenance movement has been transferred from the manufacturers, of whom a small proportion, producing trade-marked commodities, actively promoted resale price maintenance, to distributors seeking protection in a maintained resale price.

STATE RESALE PRICE MAINTENANCE ACTS

The Tydings-Miller amendment of 1937,[1] modifying the Sherman Antitrust Act and limiting application of the Federal Trade Commission Act accordingly, removed the bar of illegality to the making of minimum resale price maintenance contracts covering commodities sold in interstate commerce if they were to be resold in a State where such contracts had been legalized with respect to intrastate sales. Resale price maintenance laws—that is, laws declaring as not in violation of the law of the particular State certain kinds of resale price maintenance contracts, and providing that nonsigners of such contracts with knowledge thereof should be bound by the price stipulations therein—were on the statute books of 45 States as of May 1, 1941. Missouri, Texas, Vermont, and the District of Columbia did not have a law of this kind. The first of such laws was enacted in California in 1931, without inclusion of the nonsigner clause which was added by amendment in 1933. Similar acts, including the nonsigner provision, were thereafter enacted by other States—one in 1933, 8 in 1935, 4 in 1936, 28 in 1937, 1 in 1938, 1 in 1939, and 1 in 1941.

A large number of States adopted resale price maintenance laws in 1937, soon after the United States Supreme Court decision in the case of *Old Dearborn Distributing Co. v. Seagram-Distillers Corporation*,[2] declaring as constitutional the principal provisions, including the nonsigner clause, of the Illinois resale price maintenance law.

Of the 45 State resale price maintenance acts enacted, 16 were patterned after the original California act as amended in 1933, 21 were patterned after the model sponsored by the National Association of Retail Druggists, and 8 resembled in part the California-type act and in part the "N.A.R.D." model. The N.A.R.D. model was somewhat more elaborate than the California-type act, but the principal objects of both types were essentially the same. In brief, these principal objects embraced the stipulation that no contract relating to the sale or resale of a commodity bearing the trade-mark, brand, or name of the producer or owner, or producer or distributor, which commodity is in free and open competition with commodities of the same general class produced by others, shall be deemed in violation of the law of the enacting State, by reason of provisions in the contract that the buyer will not resell the commodity except in accordance with the price stipulations of the seller; that the vendee or producer require any dealer to whom he may resell such commodity to agree that he will not, in turn, resell except at the price stipulations of the seller; also, the so-called nonsigner clause, which declared that willfully and knowingly advertising, offering for sale, or selling such commodities at less than the stipulated contract price, whether by a party to such contract or by some other party, is unfair competition actionable at the suit of any person damaged thereby.

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[1] Pub. No. 314, 75th Cong., H.R. 7472, approved August 17, 1937.

[2] 299 U.S. 183.

RESALE PRICE MAINTENANCE IN THE FOOD TRADE

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In the States having resale price maintenance laws relatively few food products have been placed under minimum resale price contracts. In Ohio, where the most progress has been made in getting manufacturers of food trade products to adopt resale price maintenance, approximately 55 manufacturers had placed roughly 200 items under minimum resale price contracts, as of March 18, 1940. California, where the first law was in effect, has considerably fewer food trade products under contracts than Ohio, and in the remaining 43 States having resale price maintenance laws not enough food products are under contract to be significant with respect to the competitive situation among food retail dealers.

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RESALE PRICE MAINTENANCE IN THE DRUG TRADE

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. . . It was reported that in the drug store trade in June 1938, 78 manufacturers were operating under resale price maintenance contracts in each of 43 States where such action was then legal; 108 so operated in 40 or more States; and 350 manufacturers were operating under resale price maintenance in 3 or more States. In 1939, the Illinois Pharmaceutical Association listed over 400 manufacturers operating under resale price maintenance contracts in Illinois, while over 300 manufacturers had filed prices with the Ohio Fair Trade Committee—Drug Division.

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RESALE PRICE MAINTENANCE IN THE HARDWARE TRADE

Resale price maintenance in the hardware trade has made little progress, and, in terms of volume of sales covered, it is of slight consequence. This is indicated by the fact that, of the large number of manufacturers making branded hardware items, relatively few placed products under resale price maintenance contracts. The number of manufacturers who had placed products under resale price maintenance in one or more of 43 States in 1938, ranged from 12 in Mississippi, to 37 in California, and of the 44 States in 1939, the range was from 18 companies in Alabama to 40 in California. Of the 49 companies having products under resale price maintenance in 1938, 27 had such contracts effective in from 1 to 5 States, and 12 companies had contracts effective in from 41 to 44 States, while in 1939, of the 53 companies having products under resale price maintenance, 23 had contracts effective in from 1 to 5 States and 19 in from 41 to 44 States.

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Resale Price Maintenance in the Tobacco Trade

In 1937, approximately 55 per cent of the leaf tobacco consumed in the United States was used in the manufacture of cigarettes, 30 per cent in the processing of snuff and chewing and smoking tobacco, and 15 per cent in the manufacture of cigars. The extent of application of resale price maintenance in the first two of these groups was found to have been negligible, while in the case of cigars numerous brands were found to have been placed under resale price maintenance contracts. Although it is impossible to state the proportion of sales of cigars affected by resale price maintenance contracts, it has been estimated that in some States more than three-fourths of the cigar sales volume of tobacco distributors were under such contracts.

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Resale Price Maintenance in the Distilled Alcoholic Liquor Trade

There is a high degree of concentration in the production of distilled alcoholic liquor in the United States, especially in the whisky industry. In 2 of the 5 years following repeal of the prohibition amendment of the Constitution, 4 companies distilled more than 60 per cent of the whisky produced in the United States. These 4 companies, in 1938, held 78 per cent of all whisky 4 years old and over remaining in bonded warehouses.

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The National Distillers Products Corp. had, in 1938, 9 distilleries and approximately 125 brands of domestic whiskies. This distiller had some of its products under resale price maintenance contracts in some States by means of manufacturer-retailer contracts and in some States by means of wholesaler-retailer contracts. Of the approximately 80 principal brands sold by this distiller from 1934 to June 1939, 37 were under resale price maintenance contracts in California in 1936, as compared with 25 brands in Illinois and 22 in New York. In 1939, this distiller had 44 brands listed in California and Arizona compared with but 12 in Kentucky, 14 in Arkansas and 16 in Maryland. The National Distillers Products Corp. had, in 1939, placed some of its brands under resale price contracts in 18 of the so-called "open" States and in 5 additional States some of its brands were under wholesaler-retailer contracts.

Seagram Distillers Corp. has entered into resale price maintenance contracts wherever it is permissible for 13 of its brands; and its subsidiaries, Carstairs Bros. Distillers Co., Inc., and the Calvert Distillers Corp., have entered into contracts on all or at least their important brands in all of the 26 "open" States.

Schenley Distillers Corp. owns about 200 brands, approximately 25 of which are active. This distillery furnished information on 11 of its brands, from which it appears that the first contracts were entered into on May 4, 1934, in California, and in the summer and fall of 1935 at least 4 of its brands were under such contracts in California, New York, and New Jersey. This distillery has applied resale price maintenance in all of the States where it is legal for at least the more popular, if not all of its brands.

Ben Burk, Inc., had, as of September 1939, placed its products under resale price contracts, either through wholesaler-retailer or manufacturer-retailer contracts, in 14 States. Continental Distilling Corp., while "not keen about it," following the line of least resistance and acceding to the demands of retailers and wholesalers, has resale price contracts in operation in all States in which it is legal for at least some of its brands.

According to the "fair trade" directory published as a part of The National Liquor Review, in May 1939, 46 companies' products were listed under resale price maintenance in Illinois, and in Wisconsin the directory for May 1939 lists 19 companies as having products under resale price maintenance contracts. In Minnesota the liquor control commissioner, with whom all prices must be filed, reported that by October 1939, only 55 brands of whiskies, gin, brandies, cordials and liquors were under resale price maintenance.

RESALE PRICE MAINTENANCE IN THE MALT BEVERAGE AND VINOUS LIQUOR TRADES

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No definite estimate can be made regarding the extent to which resale price maintenance has been adopted in the malt beverage industry; however, it is not large. The products of large brewers with nation-wide distribution were generally not price maintained. In 1939, in Wisconsin, which produces 10 per cent of the national total output of malt beverages, no brewer had placed his products under resale price maintenance. In Illinois, in May 1939, 6 brewing or distributing companies operated under resale price maintenance contracts.

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GENERAL CONCLUSIONS

1. Minimum resale price maintenance was originally advocated by manufacturers of highly individualized, trade-marked, trade-named or branded products as a means of protecting them from unrestrained price cutting among dealers to whom the products were sold outright. When finally enacted by the States, and by the Congress, however, its enactment was urged almost entirely by a few well-organized dealer groups as a means of eliminating price competition both of dealers using the same methods of distribution and of dealers using new and different methods of distribution.

2. Leader merchandising, for the control of which resale price maintenance was advanced, is a form of price competition that obviously may be used for

unfair or deceptive trade purposes, particularly when used by large concerns to eliminate weaker competitors. As a corrective of objectionable features of price competition, however, resale price maintenance makes no distinction between price competition that is economically unsound or is unfairly used in trade, and price competition that is economically sound and in the public interest because it results in adequate service to the public at prices consistent with differences in consumer service rendered by dealers using different methods of distribution.

3. Both State and Federal resale price maintenance laws are entirely permissive in their application to manufacturers, merely granting permission to them to place their identified products under price maintenance if they so desire. In practice, however, resale price maintenance serves as a focal point for dealer cooperative effort to bring pressure to bear on manufacturers to place products under price maintenance at prices yielding dealer margins satisfactory to cooperating organized dealer groups. In some lines of trade, where the individual manufacturer has faced strongly organized dealer group pressure, the extent of his freedom of choice as to whether he will place his brands under resale price maintenance has been extremely limited.

4. Commodities to which resale price maintenance is most extensively applied are those possessing distinctive characteristics in the minds of customers. Included among such commodities are the following: proprietary articles produced under secret formulas or under the protection of patents or copyrights so that the manufacturer can determine whether there shall be duplicates of them on the market; trade-marked, branded or otherwise identified products that are advertised directly to consumers so that there is developed a widespread belief that they are superior to less well-known competing brands in quality, construction or performance; products that are so trade named and advertised as to conceal from the majority of consumers the fact that identically the same substance, or article of equal quality, may be purchased under other names, and often at distinctly lower prices; and standard articles and specialties sold under well-known brands that over long periods have come to stand in the minds of consumers as marks of a particular degree of quality, mechanical excellence, durability, etc. As to such commodities, the question arises as to how far the distinctive characteristics may be developed and still leave the commodity in the free and open competition required by the law as a prerequisite to its price maintenance.

5. Even though branded commodities may possess some or all of the characteristics fitting them for resale price maintenance, other factors may make the brand owners reluctant to maintain dealer prices. Manufacturers of staples generally have been reluctant to place their brands under price maintenance unless competing manufacturers do likewise. Manufacturers, whose products sell at prices yielding narrow margin of profit per unit sold, hesitate to undertake the responsibility and added expense of enforcing minimum resale prices. Manufacturers of brands that are sold by different types of dealers such as cash-and-carry and credit-and-delivery stores, generally hesitate to maintain a uniform minimum price for all types of dealers because to do so may entail

loss of volume from one or more of the different dealer groups. As a rule, manufacturers of staples such as flour, sugar and nails, the retail prices of which fluctuate with the prices of raw materials, have not placed their brands under resale price maintenance contracts, because to do so imposes undesirable price rigidity for their products in competition with non-price-maintained brands. Manufacturers whose branded commodities, such as canned peaches or grapefruit juice, face price competition from substitutes of other types, the prices of which may fluctuate, likewise have been reluctant to fix and maintain minimum prices for fear of placing their products at a disadvantage in competition with substitute products. Manufacturers of highly individualized products, such as radios, household electrical appliances, farm machinery and automobiles, in the sale of which a used article is often taken in trade, often have refused altogether to accede to pressure from dealers to place their products under minimum resale price contracts because the trade-in offers a ready means of dealer price competition that makes effective policing and maintenance of minimum resale prices practically impossible. Manufacturers who have entered into contracts for one or more brands of their products often have kept one or more of their other brands of such products free from price maintenance to permit continued appeal to the lower price market.

6. Application of resale price maintenance, especially with respect to staple articles, has been fostered in certain industries where production is largely concentrated in the hands of a few manufacturers, as in the case of surgical dressings, or where a large number of manufacturers are organized in closely knit trade association groups, such as in proprietary drugs and medicines, and in certain lines of grocery items including some soap products, cooking oils and firearms. When such associated groups of manufacturers face strongly organized trade groups of dealer proponents, conditions are especially favorable to the adoption of resale price maintenance. The legalization of resale price maintenance unquestionably has fostered the formation of such cooperating trade association groups both among manufacturers and among retail dealers.

7. Maintenance of minimum resale prices has been more extensively applied in the drug, toilet goods, cosmetics, liquor and sporting goods trades than in any other lines covered in this inquiry. This is due in part to the individuality lent to such products by branding, national advertising, proprietary secret formulas and the like and in part to the existence of strong cooperating trade groups of manufacturers, wholesalers and retailers. Among manufacturers of surgical supplies, a cooperating group of large companies fixed by agreement the specific prices at which their products should be sold by themselves and their wholesalers to large users, and carried the system of maintaining noncompetitive prices among their products all the way to the small retail purchaser by placing retailers under contract to maintain prices that are uniform for the same products made by the different leading manufacturers.

8. Notwithstanding an injunction of long standing against cooperative activities to coerce manufacturers to adopt any method of distribution favored by retail druggists, the National Association of Retail Druggists and its affiliated State and local associations and their officers, members and committees, among

other things, have advised druggists to support and push the sale of price-maintained brands and to do the opposite respecting non-price-maintained brands; have written threatening letters and published threatening articles in the trade press directed to manufacturers who refrained from placing their products under resale price maintenance, or who failed to enforce their prices to the satisfaction of retailers. There is strong indication that where proponent dealers are strongly organized, the optional features of the law, so far as manufacturers' actions in placing or not placing their products under resale price maintenance are concerned, are largely nullified by dealer pressure.

9. For those nationally advertised brands of drug store merchandise that were covered in the Commission's survey, the effect on consumer prices most often noted was that the prices of chain stores, department stores and certain independent stores that were selling below the minimums set by resale price maintenance contracts in resale price maintenance territory were obliged to increase prices. Individual druggists, reporting from memory, on the other hand, generally reported some price decreases in the same territory. Thus, whether a given customer paid a higher or a lower price under resale price maintenance would depend on whether he purchased from a store that was obliged to increase prices or from a store that voluntarily decreased prices after resale price maintenance went into effect. While this was happening in resale price maintenance territory, the trend for the same brands in non-price-maintenance territory often was downward in all types of stores.

10. In fixing the minimum resale prices upon which the above conclusions are based, however, many manufacturers fixed minimum prices, especially for fast-moving items, that do not yield dealers the 33⅓ per cent margin based on selling price (or 50 per cent over cost), advocated as the minimum for drug stores by the National Association of Retail Druggists. This association advised its members to accept the minimums stipulated by manufacturers with the object of pressing for higher margins later. Such pressure, however, appears to have been held in abeyance during the Commission's survey. Therefore, whether the ultimate effect of resale price maintenance will be further increase in price at some later date in order to yield higher margins to retailers would seem to depend upon whether effective dealer pressure is further exerted. In the wholesale drug trade, one effect of resale price maintenance has been to increase the wholesaler's margin by the elimination of special discounts previously given to retailers, especially on fast-moving items. Elimination of these discounts has narrowed the retailer's margin on products affected and stimulated their demand for higher minimum resale prices.

11. Drug stores, chain and department stores, that were required to increase prices under resale price maintenance, generally sold at the minimum prices named by the trade-mark or brand owner; while individual retail dealers who reduced their prices reduced them toward but not to the minimum named in contracts.

12. In the food trade, resale price maintenance has had very little application outside the State of Ohio and even in that State only a relatively small number of manufacturers placed one or more of their brands under resale price

maintenance. In general, the minimum prices stipulated were intended only to limit leader merchandising, and actually were within the range of prices being charged by Ohio chain and department stores. Chain-store operators joined with independent retail dealers in urging manufacturers to make the resale price maintenance experiment in Ohio. Few brands were placed under resale price maintenance in any other State, and even in Ohio, the fact that certain brands were placed under price maintenance had little effect on the level of prices paid for them by consumers. Among the reasons for the small application of resale price maintenance in the food trade, it is to be noted that manufacturers of grocery items generally were reluctant to place brands under price maintenance unless the makers of competing brands did likewise; that the strongest retail trade associations generally are those representing chain stores, and that, in many States, State-wide trade associations of independent stores are weak or nonexistent. Manufacturers, therefore, faced little definite concerted pressure to place grocery products under resale price maintenance.

13. In the hardware trade, resale price maintenance has made somewhat more progress than in the food trade; but here, also, it is confined largely to sporting goods and trade-marked or branded specialties. Hardware manufacturers who are reluctant to place brands under resale price maintenance unless their competitors do likewise face no nation-wide pressure from dealers favoring resale price maintenance. In the staple and heavy hardware and building material trades, resale price maintenance is largely inapplicable.

14. In the farm machinery, radio and household electrical appliance business the trading of used articles as part payment for new ones permits dealer price competition, through the medium of the trade-in, that makes the effective enforcement of resale price maintenance by the manufacturers almost impossible. Plans of wholesalers and retailers to bolster the enforcement of resale price maintenance by agreements to limit trade-in values that will be allowed and agreements to deny supplies to price-cutters have generally met with little success because important manufacturers have refused to cooperate in such plans on the grounds that they will not cooperate in carrying out dealer agreements of questionable legality.

15. In the distilled alcoholic liquor trade, many distillers and importers have been reluctant to maintain the wholesale and retail prices of their brands because of the price competition of other manufacturers' brands, importers' brands and private brands. Plans of wholesalers and retailers have been put into effect in various parts of the country to coerce brand owners, by boycotts and threats of boycott, to put their products under price maintenance and maintain them in the face of much illicit price-cutting and periodic price wars. Two complaints issued by the Commission against trade associations of distributors operating under such plans have recently produced answers admitting all material allegations of the complaints.

16. In the tobacco trade, notwithstanding the urging of organized groups of tobacco retailers and wholesalers, all of the large manufacturers of cigarettes have refused to place their principal brands under resale price maintenance. In the face of this situation, organized groups of tobacco wholesalers and re-

tailers have attempted to place numerous competing cigarette brands under retail price maintenance by wholesaler-retailer contracts made without the consent of the manufacturers owning the brands. The essence of such plans is price uniformity for competing brands in the contracts of all cooperating wholesalers, and enforcement thereof by proceedings for injunction under the nonsigner clause of State laws which make resale price maintenance contracts binding upon nonsigning retailers who do not observe the minimum prices set out in the wholesaler-retailer contracts. An Ohio State court has refused to enforce such contracts on the grounds that the minimum prices were unlawfully agreed upon by wholesalers but in New Jersey similar contracts are being enforced by the State courts in the absence of direct evidence of collusive agreement among wholesalers, or among retailers, as to the minimum prices to be maintained. Naturally, skilled operators take precaution to conceal the existence of such agreements.

17. In the malt liquor trade, manufacturers of nationally advertised brands of beer and ale generally have not stipulated minimum prices for their products. In various instances, however, cooperating groups of local brewers and wholesalers have fixed the retail prices to be maintained for local beers and, in some instances, local wholesalers, acting without the consent or knowledge of the brewers owning national brands, have placed the latter under resale price maintenance by wholesaler-retailer contracts similar to those previously described as being used for cigarettes. Two such local plans were developed in 1939 in Cleveland and Toledo, Ohio, but the Commission has no information indicating that the legality of these plans and activities under them have been before the courts of the State.

18. One of the principal arguments advanced for the legalization of resale price maintenance was that it was needed to enable manufacturers to control undesirable leader merchandising and "sales below cost." Proponents emphasized extreme price wars, and the impression was created that before resale price maintenance became effective many nationally advertised brands were sold, especially by chain stores and other large distributors, at or below invoice cost. In general, sales below invoice cost are exceptional. The records of chain stores, department stores, and super markets examined in the present inquiry indicate that although the average prices of such large distributors often were lower than those of independent stores before resale price maintenance became effective, those lower prices yielded substantial average gross margins over invoice cost of goods in all market areas visited.

After resale price maintenance became effective the price advances forced upon large distributors, especially for a number of brands handled by the drug trade, yielded larger gross margin percentages to large retail distributors than to individual drug stores as a class in the same markets, although the latter, in general, sold the brands at higher prices than the former. Thus, it would seem that the large distributors had a real advantage in pricing their goods, possibly because they purchased in larger quantities directly from manufacturers whereas small retailers were purchasing in smaller quantities from wholesalers and paying higher prices.

The "sales below cost" argument yields itself to overemphasis because it is indefinite in meaning unless "cost" is fully defined. In the hands of strongly organized groups of retailers, resale price maintenance fits well into plans to restrict price competition and enhance prices to levels yielding margins adequate to cover distribution costs and profits desired by organized pressure groups.

19. An important defect in the Tydings-Miller Act is that the right to enter into minimum resale price contracts is not explicitly limited to the brand owner or to a distributor authorized by him to place the manufacturer's product under such contracts. In those States having laws which also omit this explicit limitation, the resale price maintenance contract has been used in attempts by cooperating groups of wholesalers, or of both wholesalers and retailers, to fix prices to be maintained for branded goods without the consent, and sometimes against the will, of manufacturers or producers who own the brands. Such wholesaler-retailer contracts likewise are being interpreted by some groups as enforceable under the nonsigner clause, likewise without the consent or assistance of the brand owner. So used, resale price maintenance obviously may be perverted from its announced purpose of protecting the brand owner's interest against unrestrained dealer price competition, and be made the means of effectuating price enhancement and restraint of dealer competition by horizontal agreements among dealers, the existence of which it may be difficult to prove.

20. As the result of its investigations in antitrust cases, the United States Department of Justice has stated that, as an amendment to the antitrust laws, the Tydings-Miller Act does not serve the purposes which were urged upon Congress as a reason for its passage in that it sanctions arrangements inconsistent with the purpose of the antitrust laws, and becomes a cloak for many conspiracies in restraint of trade which go far beyond the limits established in the amendment. The conclusion of the Department of Justice is that the actual effects of resale price maintenance have been those which are to be expected from private price fixing conspiracies unregulated by public authority, whether or not they enjoy the sanction of law. The department has further stated it to be its belief that if its Antitrust Division had sufficient men and money to examine every resale price maintenance contract written under State and Federal legislation, and to proceed in every case in which the arrangement goes beyond the authorizations of the Tydings-Miller amendment, there would be practically no resale price maintenance contracts, and that, in the absence of such wholesale law enforcement, the system of resale price legislation fosters restraints of trade such as Congress never intended to sanction.

The Federal Trade Commission, which shares with the Department of Justice the function of enforcing the antitrust laws, likewise finds both its personnel and funds insufficient to adequately investigate and proceed in all matters involving possible use of resale price maintenance contracts in violation of law.

21. The essence of resale price maintenance is control of price competition. Lack of adequate enforcement of the antitrust laws leaves a broad field for the

activities of organized trade groups to utilize it for their own advantage and to the detriment of consumers. The expenses of State and local fair trade committees, all of which are trade managed and trade financed, tend to increase or to prevent decreases in distribution costs. Manufacturers and dealers alike contribute to the expense of these committees for shoppers and investigators to obtain evidence of violations of prices and to pay lawyers employed by the committees in prosecution of cases. Manufacturers joining in such proceedings for the enforcement of their contract prices likewise must incur additional investigational, legal and other expense, and accused dealers must either supinely fall into line or incur similar legal and other expense and loss of time in contesting cases before courts whose dockets already often are overcrowded to the point where further appropriation of public funds becomes necessary to expedite the handling of cases. The net result in enhancement and maintenance of high living costs is no less real because it is concealed in the prices at which goods reach the consumer in such a way that it is not subject to direct measurement.

22. The demonstrated ineffectiveness of purely voluntary resale price maintenance agreements to control the price competition of dealers who refrained from signing contracts led to the amendment of the California law of 1931 by the addition of Section 1½, commonly known as the nonsigner clause. This clause makes the price stipulated in any contract lawfully entered into under the act binding upon all dealers in the State by declaring that any person, signer or nonsigner, who willfully and knowingly advertises, offers for sale, or sells any commodity at a price less than that stipulated in any contract entered into under the law, commits an act of unfair competition actionable at the suit of any person damaged thereby. This clause, which effectively throttles all competition from nonsigners, has been copied in the laws of each of the 45 States that have enacted resale price maintenance laws. For commerce terminating in these States the Tydings-Miller Act exempts this throttling of local dealer competition from the prohibitions of the antitrust laws provided the contracts by which it is accomplished are legal in the respective States.

In passing the act, however, Congress forbade competitors to agree upon the prices to be maintained in interstate commerce. The prohibited agreements may be either among competing dealers, or among competing manufacturers. Wholesalers' and retailers' committees have sought to induce manufacturers, often by coercive methods, to place their products under resale price maintenance contracts. Efforts to police the dealer price structures are collective undertakings, which often include both signing and nonsigning dealers who, tacitly at least, agree to cooperate with the issuing manufacturers in the maintenance of minimum prices. Because a single price fixed commodity is subject to the inroads of competitors fixing lower prices, a manufacturer seldom will establish and enforce a system of vertical prices unless he knows that competing manufacturers are likewise fixing and enforcing prices at known levels. Although competing manufacturers cannot lawfully agree with each other respecting prices, they can accomplish the same result through resale price maintenance by making identical resale price agreements.

23. When the Tydings-Miller Act was before the President for signature after its passage, in 1937, as a rider to the District of Columbia appropriations bill (H.R. 7472), Secretary Wallace, of the Department of Agriculture, addressed a letter to the Director of the Budget in which he stated, among other things:

> The effect of this title [the Miller-Tydings rider] is to weaken the Sherman Antitrust Act by eliminating much of existing price competition in the retail field.
>
> . . . .
>
> It is the feeling of this Department that a further spread of measures to fix prices would be a serious handicap to quick and orderly adjustment of our economy. Even if a greater degree of price-fixing were desirable we doubt if the fixing of prices should be in the hands of individual manufacturers who would be able to enforce on the consumer any prices they chose, regardless of general economic conditions.

After the Tydings-Miller Act had been in operation for about 3 years, several Federal officials and agencies, after study of its effects, filed statements with the Temporary National Economic Committee condemning the operation of the act and stating the reasons for their conclusions. For instance, in transmitting Monograph No. 1, *Price Behavior and Business Policy*, to the committee on June 20, 1940, Isador Lubin, Commissioner of Labor Statistics, stated:

> This report indicates that there are certain important rigidities in retail prices, which prevent them from being reduced freely, and to which this committee may well direct its attention. I refer to the so-called fair-trade laws which have been enacted by 44 States and to the Miller-Tydings Enabling Act which legalizes resale price maintenance contracts in interstate commerce. I refer also to the Unfair Practices Acts which are on the statute books of about half the States and which, while purporting merely to prohibit sales below cost, seem to lend themselves to highly restrictive activities. . . .

On February 12, 1941, Thurman W. Arnold, Assistant Attorney General of the United States, filed with the Temporary National Economic Committee the recommendations of the Antitrust Division of the United States Department of Justice. Among these recommendations was the following respecting resale price maintenance:

> The Department recommends the repeal of the Miller-Tydings amendment to the Sherman Act which was passed in 1937 as a rider to the appropriation bill for the District of Columbia. . . . This amendment has been in effect a little more than 3 years. Already the record shows that it does not serve the purposes which were urged upon Congress as a reason for its passage, that it sanctions arrangements inconsistent with the purpose of the antitrust laws, and that it becomes a cloak for many conspiracies in restraint of trade which go far beyond the limits established in the amendment.

On February 21, 1941, three officials of the Department of Agriculture filed, with the Temporary National Economic Committee, a memorandum setting forth their views respecting factors affecting farm income. In this memorandum they quoted at some length from the letter of former Secretary Wallace to the Director of the Budget, in 1937, already mentioned above, and stated:

> Our ideas concerning legislation of this type are similar to those expressed in a letter written by former Secretary of Agriculture, H. A. Wallace, to the Director of the Budget. . . .

On March 5, 1941, Miss Harriet Elliott, Consumer Commissioner of the National Defense Advisory Commission, addressed a letter to the Chairman of the Temporary National Economic Committee, in which she stated:

> Repeal of the Miller-Tydings Act as proposed by the Department of Justice would restore the effectiveness of the antitrust laws in dealing with certain types of price fixing activities which the law now permits. The memorandum prepared in the office of the Assistant Attorney General dated February 10, 1941, setting forth the grounds for repeal of this act, appears to me sound, and I strongly urge that this recommendation be followed.

With these recommendations and data supporting them before it, the Temporary National Economic Committee approved the following recommendation on March 31, 1941:

> The Miller-Tydings Enabling Act, which legalizes resale price maintenance contracts in interstate commerce, results in some of those economic and social practices to be expected from private price-fixing conspiracies. The legal sanction of such practices tends to undermine the basic tenets of a competitive economy and introduces rigidities into the pricing of certain goods which restrain trade. Consequently, we recommend to the Congress the repeal of the Miller-Tydings Enabling Act.

24. In 1931, when the Capper-Kelly bill was under consideration in the Congress, the Commission pointed out that effective supervision in the public interest of prices maintained by contract for a multiplicity of products to which resale price maintenance might be applied would present very great, if not insurmountable, difficulties, as well as probably be a poor substitute for dealer competition as an effective regulator of prices to consumers. It was also pointed out that under resale price maintenance without Government regulation, competition among manufacturers would be the only remaining regulator of consumer prices with respect to price maintained articles. In its previous reports, going back as far as 1918, the Commission has pointed out that both price competition and the maintenance of prices may be used for unfair purposes in trade.

25. Both the results of the Commission's present special study of the operation of legalized resale price maintenance and information developed over a period of many years in connection with complaints strongly confirm these earlier conclusions and point to the further conclusion that in the absence of effective Government supervision in the public interest, resale price maintenance, legalized to correct abuses of extreme price competition, is subject to use as a means of effecting enhancement of prices by secret agreements and restraint of competition by coercive action on the part of interested cooperating trade groups of manufacturers, wholesalers, and retailers in such ways and to

such an extent as to make it economically unsound and undesirable in a competitive economy.

As stated at the outset of this report, the maintenance of retail prices at a fixed and uniform level, prior to the passage of the Tydings-Miller amendment, was against the policy of the antitrust laws, and prior to the enactment of said amendment, a contract aimed at obtaining this result was illegal. The purpose of this amendment, as this report shows, is not to legalize contracts whose object is to prevent predatory price cutting for an ulterior purpose. The antitrust laws do not condemn such contracts. The Tydings-Miller amendment legalizes contracts whose object is to require all dealers to sell at not less than the resale price stipulated by contract without reference to their individual selling costs or selling policies. The Commission believes that the consumer is not only entitled to competition between rival products but to competition between dealers handling the same branded product.

IX. MARKETING PRACTICES AND COSTS

SOME REASONS FOR HIGH COSTS

Neither distribution nor any other part of the economic system operates perfectly. Both the need and the opportunity to improve the efficiency and lower the costs of distribution undoubtedly exist, but the same generalization could be made about the whole gamut of activities for which the consumer pays. Whether distribution is more inefficient, or takes too large a part of the consumer's dollar in comparison with other parts of the economic machine, however, is not clear. Certainly the results of this study fail to support the common assertion that costly and wasteful distribution processes alone are responsible for high living costs.

The costs of distribution come largely from the performance of essential functions in providing time and place utilities. The mere physical task of collecting, storing, transporting, selling, and finally delivering finished goods is a gigantic undertaking. While the costs of performing these tasks have probably increased over the past years, that fact alone does not necessarily prove waste. These increased costs may pay for increased services or for expanded functions. Also there may have been merely a shifting of functions and services from what we term production to distribution. Costs may be increased as a result of the normal working of the competitive system or through the growth in the demands of consumers.

It is clear that distribution today does a vastly bigger job than it did fifty years ago. Higher marketing costs are largely due to fundamental changes in our economic organization such as the concentration of manufacturing in specialized areas, the urbanization of the population, the transfer of many production operations from the home to the factory, the development of a great variety of new products, smaller packaging, more frequent retail buying and other features of a more specialized and more complex economic life.

Furthermore, distribution, as we know it today—whether it *should* do so or not—does undertake to create demand, to mold it and to attach it to brands and dealers. Because distribution is not distribution in the narrow sense, because it is so largely devoted to influencing demand and because the art of influencing demand has developed so rapidly during the last half century, distribution has had to shoulder more expense than it otherwise would. Probably there has been as much discovery, as much change, as much innovation in the

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Source: Twentieth Century Fund, *Does Distribution Cost Too Much?* (New York, 1939), pp. 292–330. Reprinted by permission.

field of distribution as in production. But most of the ingenuity has been expended to a different end. Inasmuch as it has proved possible to influence and control consumer choice it has often been profitable to spend money in creating demand by advertising and promotion rather than through the reduction of prices.

It must be remembered, however, that the creation of this new and larger demand has helped to bring to the mass of the people an unprecedented array of physical comforts and conveniences. More and better goods have been made available to a vastly greater number of people at a price which the mass of consumers can afford to pay. Real wealth measured in the physical volume of goods produced and distributed increased more than nine times between 1870 and 1930, while the population little more than trebled. As a result millions of families have today conveniences which were unheard of seventy years ago.

This has come about partly through lower prices achieved largely by reducing costs of production. But lower production costs would often have been impossible without more effective distribution. A prominent food manufacturer reports that with greatly expanded markets the selling prices of his twelve most important products showed a decline of about 30 per cent between 1929 and 1938—in comparison with a drop of only 15 per cent in the index of all wholesale food prices and a drop of only 12 per cent in the total compensation received by employees the country over.[1]

In the six years between 1931 and 1937, the number of electric ranges in a certain utility company's territory increased from six or seven thousand to some forty thousand—all the result of selective selling. In the last ten years the price of electric refrigerators has been reduced from between $400 and $500 to an average of less than $200. Had there been a good electric refrigerator in 1920 it would have cost the consumer about $63 a year for electricity to use it. In 1937 it cost only about $12 or $14 a year for electricity to operate an infinitely better one.[2] Even during the depression years of 1931–1937 the increased use of residential electricity enabled the company to cut the average cost of electricity in homes by practically 30 per cent. The average residential customer increased his use of electricity for labor-saving devices by almost 40 per cent, yet his annual payments to the company at the end of the period were not much larger than they were in 1931. Obviously these lower costs and lower prices could not have been achieved without greatly increased consumption.

Many more examples could be given of the way in which consumers have benefited by the economic system which has been evolved. On the other hand there is considerable evidence to prove that close attention to possibilities of lowering distribution as well as production costs would result in still greater benefits. The task which faces American business is to preserve the economies of mass production by preventing the added cost of mass distribution from cancelling them out.

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[1] From an address by Clarence Francis, President, General Foods Corporation, before American Marketing Association, Washington, D.C., May 20, 1938.

[2] George E. Whitwell, "Selective Selling—Its Effects on Social and Economic Standards," an address before the Boston Conference on Distribution, September, 1937.

Criticisms of High Costs

Criticisms of the marketing structure are by no means limited to economists and students. Hard-headed industrialists and others engaged in practical business are increasingly calling attention to the urgent need of attacking the problems of distribution. The January 10, 1938, issue of *Domestic Commerce*, published by the Department of Commerce, contains two pertinent quotations illustrating this attitude:

> The facts point clearly to the logical future of American industry—namely, a bold and vigorous selective volume production along scientific management lines—scientific management, let us clearly understand, applied not alone to factory but to finance and marketing and distribution as well. . . . There is no question but that prices of manufactured goods must go down. . . . The profits in American industry must be looked for . . . in a narrow buyer's market, in specialization, research, highly developed executive management, volume at low unit profit, close management of costs and inventories, automatic production, and an organization skillfully adjusted to the market . . . and it is the principles of scientific management which today impressively corroborate the idea that the marketing function must assume supreme command. . . . As a result of scientific management in production, including, of course, scientific development of machinery and equipment, statistics indicate that unit costs of production were reduced between 1900 and 1930 some 30 per cent, while in individual operations unit costs were frequently halved or quartered. In selling, on the other hand, costs have been rising. A survey of selling costs indicates an increase of some 60 per cent in the cost of marketing by manufacturers between the same years 1900 to 1930.[1]
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> . . . .
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> There is a tremendous opportunity to recover thousands of dollars that are now being wasted in inefficiencies in our marketing structure by the application of distribution engineering to the marketing structure, and I believe also that one of the greatest chances for making big savings of all that exist in the field of distribution exists in advertising.[2]

Among the most common criticisms of the present distribution system is that it supports an excessive number of outlets and offers too many services and that excessive advertising and sales efforts put a needlessly heavy burden on the consumer's pocketbook.

To answer these charges it would be necessary—but in the light of our present knowledge often impossible—to determine how many are too many and how much is too much. And then there would remain the problem of discovering what effects a reduction in this excess would have on the various persons affected.

Among these, clearly, the consumer's interest is paramount, for distribution should exist solely to satisfy his wants. How would the consumer's interest best be served? The answer is not clear. The price he pays must be weighed against the services he wants, the conveniences he enjoys, and the range of choice he gets.

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[1] From *For Top-Executives Only*, a symposium by Samuel W. Reyburn, Kenneth Goode, Alfred P. Sloan, Jr., C. M. Chester, Sanford E. Thompson, and J. George Frederick (New York, The Business Bourse, 1936).

[2] From an address by L. Edward Scriven, of Batten, Barton, Durstine & Osborn, before the Chicago Business Papers Association, Nov. 22, 1937.

It must be remembered also that the apparent existence of an excess is a fundamental characteristic of competition. Granting that this often results in the waste of resources and human effort, it is nevertheless the means whereby costs and prices are reduced. Then too, for every commodity which has found its way into common use there may be many which have failed to find their way. The time and money spent on such unprofitable promotion must also be paid by the ultimate consumer.

Such adventuring involves not only large costs but frequently wastes. It involves the right to try and fail. Many studies of distribution have overlooked this basic feature of the American economy. Our resources are such that we obviously have the capacity to develop not merely security and a "decent standard of living," but wholly new and presumably more desirable ways of living. But no one can know in advance just what these ways will be. They can be discovered only by trial and error.

Net Balance Incalculable

No one can know definitely whether or not the net results of the distribution system which we have today leave the balance on the asset side. But it must be granted that competitive selling and modern promotional devices have created a market for the goods which industry has turned out through mass production methods. And the low costs achieved through mass production could never have been realized had it not been for the creation of mass demand and the added expenditures which had to be made to stimulate that demand. But it must be remembered that while competition in the technique of production almost inevitably reduces costs, competition in distribution often increases them.

While it is impossible to give any simple and final answer to the question "does distribution cost too much?", it is possible, and useful, to examine those aspects of the present distribution mechanism which seem needlessly wasteful. We may not be able to measure just how inefficient they are; but action to improve the defective parts does not depend on any such measurement. And to point them out may lead others to examine them more closely.

In this chapter, therefore, an attempt has been made briefly to indicate some features of our distribution system which appear to be too costly—and to give what figures are available to measure them. Some of these costs are due to the very nature of a competitive economy. But to say that they arise from competition does not mean that they cannot be cut without scrapping the system. There are other costs resulting from inefficiencies of management and still others for which consumers themselves are to blame.

1. THE COSTS OF COMPETITION

The competitive system gives free rein to all types of enterprise, and it is assumed that in the long run the more efficient type will survive. Even though each part of the process of getting goods from the producer to the consumer may function quite efficiently in its own sphere, costs may be made larger by an overlapping and pyramiding of efforts. Apparently this is what has happened in many lines of trade. Manufacturers have felt that it was necessary for them to create a consumer demand for their product in order to bring pressure on wholesalers and retailers to carry their merchandise. With the growing emphasis placed by manufacturers in recent years on the establishment and promotion of their own national brands their selling and promotional expenses have risen sharply. Witness the estimated 60 per cent increase in selling costs of manufacturers since 1900, reported earlier. . . .

A. Duplication of Sales Efforts

Consumer goods leaving the producer's hands may either be sold directly to the retailer or pass through intermediaries. In the latter case the intermediary dealer or wholesaler also incurs substantial operating expenses. In many cases only half of the wholesale expense goes to pay for the essential physical functions of breaking bulk, storage, and delivery to retailers. The other half of it goes to pay for the effort of persuading the retailer to buy. In this way a second layer of selling costs is added to the goods. Then the retailer, whether the merchandise is bought directly from the manufacturer or from some intermediary, adds his toll to the total of selling costs. It is difficult and often impossible to segregate the cost of performing the so-called "essential functions" from the expenses incurred as the result of "selling" effort. Judging from sample cost studies in manufacturers' distribution and in the wholesale and retail trades, however, at least 50 per cent of the total costs of distribution are accounted for by selling and promotional activities in contrast to the physical task of handling, storing, and delivering goods.

This is not meant to imply that such duplication of effort is wholly undesirable. The creation of demand is an essential function, and it is difficult to see how our present economy could get along without it. Granting that it is necessary, however, the duplication and pyramiding of selling effort has been carried so far in many cases as to involve real economic waste.

That economies can be effected by eliminating some of the selling activities along the line has already been shown. A discussion of food and drug distribution costs . . . showed that both corporate chains and retailer-cooperatives were able to perform the wholesaling function at lower costs than independent wholesalers. Their economies result from the fact that they do little or no "selling." It is also quite probable that the selling costs of most manufacturers supplying these large-scale organizations are relatively low. Obviously, exact information on this important question must await more realistic and careful cost analysis and allocation.

It is of immediate concern to consumers, however, that in the fields which they have invaded, the chains and retailer-cooperatives have brought lower prices resulting in part at least from a marked reduction in the combined costs of performing the wholesaling and retailing functions. The number of retail stores belonging to such integrated organizations is usually closely geared to the potential business in the area served. Thus each such retail outlet is able to enjoy a volume of business large enough to justify its existence and to insure relatively low operating expense. The same advantage is not enjoyed by vast numbers of so-called "independent" outlets.

B. Multiplicity of Outlets

The great duplication of facilities in retail trade must result in a higher total cost of distribution than if outlets were fewer. The high rate of mortality, which continues in good years and bad, indicates that too many firms are engaged in many retail trades. Hundreds of thousands of retailers do a pitifully small volume of business. Even in 1929 over two-fifths of all the retail stores in the United States had a sales volume of less than $33 a day. In 1935 about 60 per cent of all retail stores were in this class. Operating expenses for this group of little stores are much higher than those of larger establishments, if anything like reasonable compensation is allowed their proprietors.

Supplying these superfluous retail stores also makes for high distribution costs. Manufacturers and wholesalers obviously could operate more economically if their output could be handled exclusively by stores which do enough business to stock up with large orders, achieve a quick turnover by selling at a small margin of profit, and send in more large orders. It is obvious also that retailers could conduct their operations more economically. Fewer and larger stores would mean fewer and larger purchases and lower costs of physical handling and selling, as well as many collateral savings such as lower insurance and credit and collection costs.

But from the standpoint of consumers, it must be admitted that an ideal system of distribution from the point of view of distributors would have its drawbacks. If all stores were large they would necessarily have to be fewer and farther apart. But consumers want a system which enables them to supply many of their wants in stores which are easily accessible. While the average housewife on the outskirts of the city may go to the big shopping district for her major purchases, she does want a convenient store just around the corner. Here, as in many other phases of distribution, no sharp line can be drawn between real economies and those which would involve sacrifices in convenience on the part of consumers.

C. Services Rendered

Much of the cost of distribution attributed to competition comes from extra services extended to buyers. These services are often intangible and difficult to measure. They may be worth all they cost; but in many instances, if all the facts were known, they might well be classed as waste. We do not have the facts, however, to permit a statistical comparison between the costs and values of such services.

By greatly reducing services, costs can be cut substantially, and such savings have been made by many manufacturing, wholesaling, and retailing establishments. That such economies have not been more widespread is apparently due to the willingness of buyers to pay not only for merchandise, but for service and for freedom of choice in buying a wide range of products. Professor

James L. Palmer of the University of Chicago lists some of the services which our marketing institutions might eliminate to cut the cost of distribution:[1]

1. They might discontinue selling for credit.
2. They might eliminate free delivery service, reduce the frequency of delivery or narrow delivery zones.
3. They might carry fewer brands of merchandise, thus restricting buyer choice.
4. They might stock smaller quantities of merchandise and refuse to handle slow-selling items, thus forcing many buyers to wait for delivery of orders.
5. They might occupy low-rent locations, thus forcing buyers to go out of their way to make purchases.
6. They might operate on an eight-hour instead of an eleven-to-eighteen-hour day, thus concentrating buying in shorter periods but also restricting service.
7. They might sell only in quantity, thus eliminating small-unit purchases.
8. They might locate only in large trading centers, thus inconveniencing people not living nearby.
9. They might confine themselves to staple merchandise instead of aggressively seeking out new merchandise and new styles, thus reducing obsolescence losses and mark-downs.
10. They might withdraw the returned goods privilege, thus reducing selling and handling costs and mark-downs.
11. They might reduce the number of salespeople, thus cutting labor cost but compelling customers to wait to be served.

Professor Palmer makes the guess that a retail store operating under these conditions could cut the cost of retailing in two—if it had any customers left. He can see no immediate prospect of material reduction in the cost of marketing except through restriction in services.

If consistent effort is made to discover the facts, savings can undoubtedly be effected. However, as long as the distributor does not know what it costs to sell small accounts, fill small orders, grant credit, accept returned goods or grant allowances for this or that, just so long is he apt to excuse high costs. He thinks he is compelled to render such services because his competitors do. Thus he argues that they are merely a form of advertising or sales promotion. Such reasoning may be sound enough if he knows what the services really cost, but very few distributors do know what they cost. From the buyer's point of view it is too often true that buyers must pay for elaborate services whether they want them or not. To the buyer who does not require services it seems important to have the costs borne by those who benefit from them.

D. MULTIPLICITY OF BRANDS

Today the consumer is offered a multitude of products unknown to his grandparents. He must choose among a bewildering array of labels; a host of different brands of cigarettes, toothpaste, shaving cream, cosmetics, and breakfast foods are on sale in every retail store. The late George K. Burgess, former director of the Bureau of Standards, estimated that there are as many as 10,000 brands of wheat flour, 4,500 brands of canned corn, 1,000 brands of canned peaches, 1,000 brands of canned salmon, 1,000 brands of canned peas, 500 brands of mustard, and 300 brands of pineapple.[1] But only a few brands of each kind of product are carried by any single store. Furthermore, the major part of the consumer's budget is still spent for a multitude of products—ranging from household furniture and hardware to clothing and many staple foodstuffs such as meat and vegetables—which are sold to him in bulk or simply on the retailer's recommendation.

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[1] *The Journal of Marketing,* April, 1937, pp. 391, 392.

Four major charges of high costs due to the multiplicity of brands have been made: (1) they confuse rather than enlighten the consumer and make his purchasing less efficient than if the number of brands were greatly reduced and each brand were identified with recognized specifications or standards of quality; (2) the large number of brands reduces manufacturing efficiency by permitting inefficient plants to survive and by preventing a concentration of production in large plants which enjoy the economies of mass production; (3) distributors, particularly retail stores, are required to tie up large amounts of capital in carrying a needed supply of each type of branded goods; (4) competitive national advertising and the promotion of almost identical products under different brands is a large and unnecessary expense which needlessly increases costs and prices.

The Effects of Multiplicity

Mere wonderment as to which of so many brands are best suited to particular needs may not trouble consumers very much. The retail buyer may pay no attention to labels, trusting to the dealer to understand that he wants good merchandise. If there is a great difference in price between one brand and another, buyers may assume from lack of information that there is a corresponding difference in quality. Sometimes—but not always—this is true. But the consumer who values quality above everything may choose the highest priced product, quite unaware that some distributors understand this trait of human nature and price inferior goods accordingly.

Ordinarily, however, the consumer has to consider prices. Privately branded goods are commonly sold on a highly competitive basis with price the primary consideration. Goods sold under private brands, however, can be distributed as economically as if they were not branded at all, and consumers would have to pay the same price in either case. Goods must be labeled and their contents must be identified in some way, and the additional cost of adding the dealer's name to the label is inconsequential. What is important to buyers is whether content and quality are as represented and whether the description is one which can be readily understood.

The existence of a multitude of private brands probably has little effect on the efficiency of manufacturing. Each of the 10,000 brands of wheat flour is not produced in a separate mill or according to a separate formula. Production costs for flour are little if any greater than if fewer brands existed. As a matter of fact, only 4,022 establishments in all are listed by the Census as producing flour or any other kind of grain-mill products, and 70 per cent of such products is milled by the 232 plants doing a business of more than $1 million annually.[1]

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[1] Sumner H. Slichter, *Modern Economic Society* (New York, Holt, 1931), p. 553.

Hundreds of wholesalers and chain store organizations buy identical products from a single mill, each one having his merchandise labeled with his own brand name. This practice is also common in the canning industry, in the apparel trades, and in many other commodity lines and is often followed even by producers who distribute part of their output under their own nationally advertised brands. Clearly, if no advertising is involved, it costs little more for a manufacturer to produce and package the same product under a hundred brands than under a single brand or no brand at all.

Furthermore, carrying a modest assortment of private brands may add little to inventory expense. Since consumers often (but not always) attach no special value to any particular private brand the dealer's only concern is to be able to offer his buyers a sufficient assortment of sizes, styles, and qualities of the product, whether this necessitates stocking several private brands or only one. On the whole it is doubtful whether the apparent multiplicity of brands is responsible either for excessive costs in manufacture and distribution or for consumer ignorance or inefficiency in buying. The latter undoubtedly exists; but it is due chiefly to the fact that consumer goods are not available under standards and specifications, rather than to the variety of names under which they appear. This is discussed later . . . .

E. COMPETITIVE ADVERTISING

What has just been said about privately branded goods does not apply to articles sold under the manufacturer's national brand. The selling of these goods, especially those of almost identical nature, involves a large amount of competitive advertising. Among the kinds of goods whose production cost and inherent qualities do not vary greatly from one brand to another, but which are advertised extensively by the manufacturer, are cigarettes, toothpaste, shaving cream, packaged medicines, cosmetics and many other drugstore products, bread, gasoline, and possibly automobile tires. The list of nationally advertised products is of course much more extensive and includes many products like automobiles and radios which vary widely in quality.

Whether or not real differences exist, the manufacturer uses national advertising to create consumer demand by extolling the special virtues of his own product. Much national advertising makes no serious attempt to emphasize the supposed superior features of a product but is designed merely to create "consumer consciousness" for the particular brand. Whatever the nature of the advertising, the consumer often pays more for a nationally advertised branded article than for a similar article sold under a private brand or no brand at all. Being forced to choose among several private brands of a commodity like canned corn costs consumers little or nothing, but the cost of having a choice among advertised brands of toothpaste, for example, may be appreciable.

Not only do buyers pay more for branded articles than for unbranded ones; but, curiously enough, they often pay more for the latter than if the branded article were not advertised. Because of advertising and other expenses—and often higher profits—on the advertised product, it carries a high price. Since this price rather than cost or inherent value establishes a standard of value in the consumer's mind, the retailer, buying an unbranded substitute at a much lower price, is able to sell it at a higher mark-up than he otherwise could.

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[1] *Census of Manufactures: 1929*, Vol. I, pp. 78–81.

Pros and Cons of Advertising

Advertising as a technique of selling is clearly necessary in the marketing of many kinds of goods. It is a useful selling method which, like other selling methods, can be used for bad as well as good ends. It may, and often does, make large-scale, low-cost distribution possible. It may, and usually must, result in maintaining standards of quality. And it may, and often does, create a demand not only for the advertised product but for many unadvertised substitutes. It is not safe to conclude that even substitute brands, now able to take advantage of the "price umbrella" raised by national advertisers, would be sold more cheaply if the national advertising were to stop. Perhaps the general demand created by advertising would also stop. Moreover such by-products of advertising as the radio and magazines and newspapers may be worth more to the consumer than the added cost of the advertised commodities.

Advertising has undoubtedly widened the market for automobiles and other products so greatly that the ultimate price to the consumer is far less than it would have been without advertising. Clarence Francis in a recent address before the American Marketing Association said:[1]

> When General Foods first took over the Jell-O Company, Jell-O was selling to the consumer for an average of 12 cents per package. Today the prevailing price is around 5 to 6 cents per package. The whole Jell-O enterprise was developed largely through advertising resulting in large production and wide distribution, with attendant economies. The total advertising cost at present is less than one-half a cent per package.

Few will question the important social aspects of certain types of advertising. Advertising is needed to educate the consumer to use new products, particularly those of a technically complex nature. Air conditioning, hydraulic brakes on motor cars, the importance of vitamins in diet have all been made familiar to the consumer through advertising. But it is just as true that the consumer has been bombarded with bombastic claims about useful products and with a lot of nonsense about useless or harmful ones. Some advertising has undoubtedly led buyers to use foods that were not good for them. Some advertising has pushed harmful laxatives and patent medicines, the sale of which to the American people is enormous. Yet a good deal of modern competitive advertising makes for better living by encouraging the use of healthful products and promoting habits that are socially desirable—such as the regular brushing of one's teeth.

Competitive advertising deserves a critical analysis so that the more useful features may be retained and the harmful and wasteful ones eliminated. That this point of view is actually being adopted by advertisers is evident in the self-criticism apparent in trade association meetings of recent years. It is shown in a practical way by the fact that the Association of National Advertisers is sponsoring a thorough and impartial survey of the economics of advertising, which is being conducted by the Bureau of Business Research of the Harvard Graduate School of Business Administration.

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[1] From an address by Clarence Francis, President, General Foods Corporation, before American Marketing Association, Washington, D.C., May 20, 1938.

2. THE CONSUMER AND DISTRIBUTION COSTS

Consumers have been both the victims and the cause of higher distribution costs. The urbanization of the population, higher standards of living, and the consequent refinement and elaboration of consumer tastes have been accompanied by a demand for new and costly services and a wider range of choice. Producers and distributors feel that they must cater to this demand or go out of business. On the other hand, it was some enterprising producer or dealer, perceiving the possibilities of increased sales, who first offered each one of these innovations to the public. The increasing cost of distribution which results from them cannot be set down as wholly the fault of either consumers or distributors.

A. NEW DEMANDS AND SERVICES

Consumer insistence on purchasing small amounts of staple commodities, for example, increases the cost of packaging and selling. In part this existence on small sanitary packages is the result of national advertising and sales promotion, which aim to attach to staple commodities intangible and often imaginary values in the form of sanitation, convenience, and so on. In part the consumer's insistence on small orders is due to changes in our housing habits. We live in smaller apartments and have less storage space than even a quarter of a century ago. As a result consumers—whether because of sales pressure, changing habits, or both—have shifted to producers and distributors a service which they formerly performed for themselves—the storage and preservation of commodities.

Illustrations of higher costs of distribution due to new commodities and new services, as well as to consumer caprice fostered by modern advertising, can be found in women's apparel. Thirty or forty years ago women bought piece goods by the yard at the store and had them made up into clothes at home. Today the typical woman consumer expects to buy a finished dress suited to her own taste and conforming to prevailing styles. This change obviously burdens distribution and increases the price of the finished product. It is more costly to distribute thousands of dresses, often with only one of a model or pattern to be sold within a given locality, than it is to sell staple yard goods. By shifting the making of dresses from the home to the factory, production costs have undoubtedly been reduced; but by making it necessary to distribute a more highly finished and individualized product through the regular channels of trade the cost of distribution has been greatly increased.

The Cost of Variety

The consumer who has been made style-conscious feels compelled to buy more articles and to discard them or trade them in sooner than he otherwise would. Women's apparel no longer wears out before being thrown away, and the cycle of obsolescence has likewise been shortened for many other kinds of goods. The increased emphasis on color harmony as an element in style is another trend in the same direction.

Consumers demand more variety today than before. A woman who buys a dress from a department store and sees another dress like it at the next party she goes to feels outraged. The result is that manufacturers of medium- or high-priced dresses find it hazardous to sell more than one dress of a kind in each small town, and sales in larger towns are also limited. Clearly, distinction is a larger element in style goods than inherent quality. Or the consumer may want to "keep up with the Joneses." He buys a new automobile because the man next door has bought one; he wants something to boast about, if possible—more gadgets, more miles per gallon, more speed. His wife may buy things for the home with the same motive—desire to keep up with the neighbors or, better still, to excel them.

Of course producers and distributors welcome this psychology and do all they can to promote it. They exercise every ingenuity to invent new sales appeals—frequently irrelevant to the value of the product—which provide the appearance of individuality and originality.

The tremendous variety of styles and their rapid obsolescence raises costs all along the line. Manufacturers must carry a wider assortment of raw materials, purchase them in smaller quantities, and provide increased factory capacity to fill rush orders. Wholesale and retail distributors must incur greater operating expenses in carrying larger and more varied stocks of goods and run a much greater risk of inventory loss through failure to clear stock before a style change necessitates a mark-down.

The Department of Commerce notes color obsolescence as "one of the principal factors slowing down turnover" in the women's silk and rayon hosiery field. The Holeproof Hosiery Company carried 480 items in 1920 and 6,006 in 1927. Leverett S. Lyon reports that a leading Chicago retailer of shoes increased the number of styles of men's shoes carried from 175 in 1920 to 375 in 1928 and in women's shoes, from 500 in 1920 to 1,000 in 1928. A large Middle Western wholesale dry-goods house estimated that "20 per cent of all its items become obsolete before they can be sold." [1]

Returned Goods

Another cause of higher costs created by consumers' buying habits is the return privilege of department and other stores. A customer who orders several articles on approval with the intention of buying only one, or who returns an article three or four times because it does not suit, adds to the costs of distribution. Moreover, she penalizes the customer who does not return goods, but who must nevertheless pay the increased retail price necessary to cover the cost of this service. Returns and allowances constitute on the average the equivalent of one day's sales out of every eight in department stores.[1]

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[1] Robert S. Lynd, *Recent Social Trends*, Vol. II, p. 870.

A recent writer has said about this problem:[2]

> One cannot be sure of tracing down all the costs that enter into the return of merchandise . . . . The cost of making these adjustments, which includes the cost of handling goods at no profit, is nothing compared with the losses accompanying unsalable goods or merchandise that has to be resold at drastic mark-downs. The economic waste involved runs into millions of dollars.

In a comprehensive survey conducted by the Department of Commerce consumers who were questioned blamed themselves largely for the returned goods evil.[3] Nearly 48 per cent of the women questioned in the city of Washington reported that they were at fault, about 26 per cent said the retailer was responsible, and not quite 16 per cent laid the blame on the manufacturer of the goods. Women reported that over 56 per cent of the articles returned were intended for their own use. In most cases, therefore, greater care at the time of the sale in selecting and fitting the article would have avoided the necessity for the return. Obviously this is as much the retailer's as the buyer's responsibility.

"Wrong size" accounted for over 30 per cent of the returns and of these nearly 90 per cent were attributed to "wrong size asked for by customer," according to a study made by the Bureau of Business Research of Ohio State University in 1926. This study states that for the routine handling of a typical return transaction it required not less than 23 persons to perform the necessary operations involved. The cost of each transaction varied from 31.8 cents for a "charge-take sale" to 61.6 cents for a "charge-send sale."

B. CONSUMER IGNORANCE

Most consumers are not rational buyers. By the trial-and-error process of shopping, usually involving repeated visits to the store, the woman shopper may find something that will do. But she does not realize that she has wasted too much of her own time and nervous energy and that the services of the store in taking back unsatisfactory goods and making extra deliveries, the time of the sales person, complaints, adjustments, and damage to merchandise all increase overhead costs which she and other buyers have to pay. In other words plain consumer ignorance increases distribution costs. For this consumers must share responsibility. But the manufacturer and the distributor are also responsible in so far as they help to maintain the consumer's ignorance and exploit his indifference.

Even the careful buyer may find it impossible to learn anything at the time of sale about the actual use value of textiles. The composition of cloth can no longer be determined by the standards of sight and touch which have guided most women in buying dress goods from time immemorial. Certain synthetic fabrics now imitate wool so perfectly that even experts can hardly tell them apart; but the way they wear may be quite different. Many of these imitations are labeled inaccurately or deceptively—some not at all—and sales people frequently know no more about them than the customer.

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[1] Carl N. Schmalz, *Operating Results of Department and Specialty Stores in 1933* (Harvard Business School, Bureau of Business Research, Bulletin No. 92), p. 1.

[2] Daniel Bloomfield, *The Returned Goods Problem,* Report No. 240 (New York, Alexander Hamilton Institute, 1933).

[3] *Consumer Viewpoint on Returned Goods,* Domestic Commerce Series No. 87, U.S. Bureau of Foreign and Domestic Commerce (Washington, D.C., U.S. Government Printing Office, 1934), pp. 12, 16.

In recent years, however, certain manufacturers have been pushing a campaign for "truth in textiles." They say that public opinion is insisting that producers and distributors tell the public exactly what they are buying. In so far as this campaign succeeds, the costs of distribution and prices can be reduced.

Differences in price often fail to reflect real differences in quality—either in the products themselves or in the services required to sell them. Although a branded article with the label of a well-known manufacturer or distributor is usually of uniform quality, the consumer has no assurance that the quality is high or low. He can judge that only after he has bought and used the article.

A dramatic example of the discrepancy between price and quality has been cited by Dr. Slichter.[1] Twenty-four cans of corn were bought to be used as a test in a grading school. They were graded by experts according to United States Government standards. One can, judged U.S. grade A, or "fancy," cost 17 cents; fourteen cans graded U.S. grade B, or "extra standard," averaged 14.85 cents each; and nine, graded U.S. grade C, or "standard," averaged 16.92 cents. The price of the poorest corn was higher on the average than that of the medium and almost as high as the one can of "fancy" corn.

Slichter also cites strength tests of five Turkish towels, which showed that a 25-cent towel was a better buy than one priced at 50 cents and a $1.00 towel far superior to a $1.50 one. In a test of five other towels the highest priced towel was fourth in quality. Tests of the warp and filling strength of six suits of men's cotton underwear gave similar results—suits priced at $1.50 were of stronger weave than the $2.25 and $3.00 suits.

Informing the Consumer

The importance of making readily available to consumers the essential facts about merchandise is a lively issue today. But opinions differ about the best ways of doing it.

The Bureau of Agricultural Economics of the Department of Agriculture favors the grading and labeling of goods according to rigid government requirements. Grades based upon government standards arrived at by test have been officially established for all of the principal raw agricultural products which can be measured by physical test, such as tobacco, cotton, and grain. Some fifty-five kinds of fresh fruits, vegetables, and nuts are also graded according to size, color, and maturity. The Bureau bases its standards on actual study of the practices of growers, packers, and shippers of agricultural crops, fruits, and vegetables. The use of the government grading service is voluntary and a fee is paid for it. Many states now compel the sale of certain products on the basis of grades, although not necessarily those of the Department of Agriculture.

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[1] Slichter, *op. cit.*, p. 551.

Some advocates of the Department of Agriculture grading system believe that it could be extended to all or most consumer goods. A bill to require government grade labeling of consumer goods was recently presented in Congress but failed of passage. Opponents of grading contend that a rigid system for all products would be impracticable and unsatisfactory. They say that the education of the buying public to use the labels would be no small task; and that it would be impossible to devise standards flexible enough to cover the infinite variety of qualities which make for consumer satisfaction.

Descriptive Labeling

Packers have opposed the Department of Agriculture grading system for canned goods on the ground that it is not sufficiently clear and that it might encourage the advertiser to try to convince purchasers that his particular grade A or B was superior to another packer's grade A or B. They advocate voluntary descriptive labeling, contending that the label should be "the window of the can," permitting the consumer to find out exactly what is inside. A label used by a packer of prunes, for example, bears the following information:

Fruit quality	Good
Sweetening	Unsweetened
Flavor	Full ripe
How canned	Whole
Net contents	6 lbs. 6 oz.
Approved for	Table use, pies, preserves

In the effort to open the window still further, some labels picture the exact size of the fruit or vegetable in the can—for example, the label of one brand of ripe olives, which carries a full-size picture of the fruit, states: "This can contains about 46 olives this size. Net weight, 9 oz. or 255 grams. Packed and sterilized under supervision and according to regulations of State Department of Health."

The advantage to the consumer of this sort of label over lyrical names and highly colored pictures is obvious. Its weakness lies in the fact that its use would now be voluntary, as there is no legal compulsion on the producer to label his goods clearly, completely, and accurately.

The new Food, Drugs and Cosmetics Act, signed by the President on June 25, 1938, outlaws harmful and adulterated products and requires packaged foods to be labeled to show weight and volume. If canned fruits and vegetables are below certain legal minimum standards (which have not yet been established for most products), the label must so state. Beyond this the law merely requires that the label must not mislead or deceive the purchaser.

Size Labeling

The need for accurate size labeling of wearing apparel is apparent to every woman who buys ready-made garments, and should be to every retail merchant who complains about the returned goods problem. A shopper asks, for example, for a child's size nine dress in a particular style. Out of nines at the moment, the saleswoman shows an eight, saying that it will probably fit because "this style runs large." The customer may find when she gets home that it does not.

This standardization of sizes of children's garments is the object of an extended research project now being carried on by the Bureau of Home Economics of the Department of Agriculture with the cooperation of the American Standards Association and several associations of manufacturers of patterns and of children's clothing. It is planned to measure approximately 100,000 children of pre-school and school ages, from high, medium, and low income groups and from different racial groups. A report and statistical analysis of the data will probably be published during the present year.

This valuable work will be partly nullified, however, so long as garments are made of fabrics which shrink or stretch in laundering or cleaning. Most shoppers ask about shrinkage, and usually receive a stock answer to the effect that "there have been no complaints," or that the sales person does not think it will shrink. But the size nine becomes size eight in the wash, and another dress must be bought—size ten this time, "to allow for shrinking." This prolific source of waste and inconvenience seems wholly without excuse in view of the methods now available for pre-shrinking fabrics. Many consumers now look for the "pre-shrunk" label.

Other Consumer Aids

The Agricultural Adjustment Administration has inaugurated a Consumers' Counsel Division which publishes the *Consumers' Guide*, a bi-weekly bulletin. The nature of this publication is evident from a typical table of contents: "Facts for Blanket Buyers"; "Check your Vitamin C"; "Should Consumers Unite?"; "Cooperation"; "Milk Producers and the Cooperative Way." The Department of Labor has a Standards Section of a Consumers' Project, successor to the Consumers' Advisory Board of the NRA and heir to the fund of statistical data on consumers' standards collected by that organization. The Standards Section has continued to collect and assemble government standards and specifications on consumer goods.

A few private groups have organized to apply scientific tests to consumer goods and to make known the results to their members. These groups have in most cases small capital and limited laboratory facilities, but their activities have shown what can be done. Consumer's Research, Inc., and Consumers Union of U.S., Inc., undertake to make their own tests of products which they name specifically in their reports to subscribers, with detailed comparisons of ingredients, performance, quality, and so forth, of the different brands of a given product. Another organization is Cooperative Distributors, Inc., which publishes information on commodities, and functions as a consumers' cooperative in the sale of standardized articles.

Some progressive department stores have recognized the advantages of promoting consumer interest in quality, and have set up their own bureaus of standards. The Consumer-Retailer Relations Council, sponsored by a few of the important retail interests, has made some headway toward defining and establishing standards for various kinds of consumer goods. Women's clubs and women's magazines are also increasingly active in the field of consumer education. Much remains to be done, however, both on the part of distributors and organized groups of consumers before the retail customer can approach his task with sufficient information to be able to discharge it wisely. Ignorance on the part of consumers and their consequent failure to get the most for their money is sometimes due to sheer stupidity, but more often to lack of information rather than lack of intelligence.

3. The Costs of Inefficiency

Some of the high costs of distribution excused by distributors on the ground that "competition forces me to do it" are really due to ignorance of their own costs. Distribution in the modern sense of merchandising and demand creation is of recent origin. It has developed rapidly an amazingly effective technique in selling a multitude of new and varied products. But in the hectic struggle to educate the consumer and sell more goods, distribution has lagged behind in the application of scientific methods to the study of operations and the control of costs. Also, it must be recognized that the task of determining and allocating costs in distribution is much more difficult than in production. But ignorance of costs breeds high costs, or at any rate prevents high costs from being detected and reduced.

In the early days of machine industry, production was conducted with the same lack of knowledge of the cost of its various processes as is distribution today. But since then careful studies have gradually been made of most of the processes in production. The progressive manufacturer today is likely to have accurate data on how much any one of the processes in his plant costs him and how much time is consumed in performing it. This is by no means universally true, but even in the less efficiently run plants there is more genuine information about production costs than about almost any part of the distribution process.

A. Difficulty of Measuring Costs

It is relatively easy to measure the material and direct labor costs in making and packaging a common article like a tube of toothpaste. Such a product is made under standard conditions, and the amount of raw materials, labor, and machine time required to produce a single unit can be determined accurately. Even such factory overhead costs as inspection, supervision, record-keeping, taxes, and insurance can be allocated with reasonable validity. A new enterprise could closely estimate how much it would cost to produce such a standardized product if a million customers could be induced to buy it regularly. But what it would cost to create this demand cannot readily be computed. Nor would it be easy to compute the cost of distributing and selling the product to the million potential users.

But that is not the whole story. When the manufacturer sells 10,000 tubes to a wholesaler, the wholesaler—although he may have a cost accounting system—is not likely to know how much it costs him to handle this particular commodity. He probably knows what it costs to store this toothpaste together with all his other stock, and what it costs to distribute the whole volume of merchandise sold by him to a thousand druggists. But this is an average figure and takes no account of important differences in cost of selling different items, of filling orders of different size, of selling to different customers, and of shipping goods into different territories. And these differences are the vital elements in wholesalers' costs.

So also when the toothpaste is delivered to the retailer. He adds it to his inventory, which includes hundreds or thousands of articles bought from different wholesalers or manufacturers. If he thinks about analyzing his costs at all he is confronted with a complex job. The average store is not large enough to warrant specialization of personnel or space. Hence the allocation of these costs in retailing is even more difficult than in wholesaling.

The relatively large proportion of total distribution expense represented by the costs of selling, advertising, and promotion are usually allocated to different products on the basis of their dollar volume of sales or their gross profits. In other words, these expenses are charged roughly in accordance with the distributor's selling price or mark-up on each commodity. It is quite unlikely, of course, that this method will result in allocating expenses according to actual costs incurred, since the cost of selling any particular article may vary widely from the average cost of selling all products carried by the firm. Often, of course, there is a rough and ready recognition of these differences by charging a smaller gross margin and paying a lower selling commission on items with a rapid turnover. Margins are rarely established, however, as a result of a commodity-by-commodity and customer-by-customer analysis of actual costs incurred.

Problem Being Attacked

But some progress in this direction has already been made, particularly in the allocation of internal handling costs in wholesale and retail establishments. A good example is furnished by the *Louisville Grocery Survey* conducted by the United States Department of Commerce. In this study six different operations or functions in wholesale establishments were identified: investment, storage, checking, handling, promotion, and reimbursement.[1] Similar studies have been made by the Department in wholesale confectionery, in retail and wholesale drugs, and in the retail grocery business. Some of the larger and more progressive wholesalers and retailers have developed their own methods of cost allocation, while others are following the patterns suggested by the Department of Commerce.

The Standard Oil Company of New Jersey in recent years has applied the time study principle, long familiar in factory management, to an analysis of both wholesale and retail operations in the distribution of gasoline and other petroleum products. In making these studies, a checker with a stop-watch times and records the specific operations of each person employed in handling the firm's products.[1] Detailed information has resulted from these studies on such matters as the average amount of sales, the number and type of customers, the percentage of idle time and free-service time of employees, and the time required to fill orders of various kinds. These data have been extremely useful not only in establishing costs and prices but also in solving operating problems.

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[1] *Wholesale Grocery Operations, Louisville Grocery Survey*, Distribution Cost Studies No. 14, U.S. Bureau of Foreign and Domestic Commerce (Washington, D.C., U.S. Government Printing Office, 1932), p. 10.

Dr. Surface states that "the cost of these studies has been paid for several times over in the influence which they have had in reducing obviously unprofitable operations."

Another approach to the same problem has been made by the Dennison Manufacturing Company, which has developed a method of allocating the cost of handling orders. It is now engaged in establishing the basis for proper allocation of sales solicitation costs among different sales territories and types of customers. Information has been obtained from the accounting records of selling expense for the company's five major sales regions. Call-cards made out by the company's salesmen are also used. These give the amount of the order, the length of time in making the call and other information for each salesman's visit.[2]

This analysis "must be regarded only as a very initial step along the long road to the development of adequate selling costs." But it has already shown important variations in the cost of salesmen's calls on various types of customers in different regions and in the amount of the order received at each solicitation. This study is expected to provide a sound basis for computing selling costs and also to reveal opportunities for important economies.

B. ZEAL FOR VOLUME

The emphasis on volume, so characteristic of American business in the twentieth century, has been responsible for increased costs in distribution. A wholesale house or a department store, like a factory, must meet fixed costs for taxes, rent, light, heat, etc., regardless of the volume of sales. As the sales volume increases, these fixed costs become less per dollar of sales. The temptation is great to get savings through larger volume. But these savings are often more than offset by a disproportionate increase in the direct selling costs necessary to get the added business.

Acceptance of smaller orders, doing business with smaller and less reliable customers, granting additional services, sending salesmen into more remote and less concentrated markets, and the use of more advertising and promotional efforts—all these increase costs. The distributor, like the farmer, is subject to diminishing returns in extending his market into less fertile territory. It is often actually to the financial advantage of the distributor to curtail volume—

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[1] The methods and results of these studies were explained fully by Dr. Frank M. Surface in "Time Studies in Commercial Research Work," published in *The Society for the Advancement of Management Journal,* Vol. I, No. 1 (January, 1936).

[2] F. J. Naumann and A. C. Farrell, report on *Field Solicitation Costs* prepared for the Dennison Manufacturing Company, Framingham, Massachusetts, and issued February, 1934.

by eliminating unprofitable lines, dropping small or unprofitable accounts, refusing small orders, and abandoning high-cost sales territories.

High Costs of Small Orders and Small Accounts

A number of studies made by distributors and by various research organizations give striking evidence of the high cost of selling small accounts and handling small orders. In a study of wholesale jewelers, made by the Department of Commerce for the years 1928–1930, various expense items were found to be from two to four times as great per $100 of sales when the average annual sales per customer were less than $250 as when they were $750 or more. Travel expenses, for example, were $3.81 compared to $1.91; packing and shipping wages were $1.25 compared to $0.27.[1]

One wholesaler made a careful study of his costs and found that nearly half his customers were unprofitable to him. These customers were dropped; sales territory was reduced about 33 per cent, with savings in traveling salesmen's expenses; and slow-moving lines were dropped. As a result, the volume of sales was reduced by a third. But after a three-year operating test in the restricted sales area with a reduced line of goods it was found that net profits had increased 35 per cent. Operating costs were reduced to a level below the average for similar firms in this particular field.[2]

A study by the Department of Commerce of the operations of manufacturing confectioners in certain western states reveals the unprofitability of items with a small average value per order. Items ordered by customers over fifty times in a six-month period, with an average value per order of only $2.78, showed a net loss of 2 cents per order. Items ordered less frequently were bought in larger quantities up to an average of $5.89 and showed appreciable profits and relatively lower distribution expenses per order. The unprofitable part of the business, however, amounted to nearly three-fourths of total sales. The same study revealed that a 40 per cent gross margin was required to enable the distributor to break even on a $2 order, while only a 25 per cent margin was needed on a $5 order.[3]

Eliminating unprofitable customers and reducing advertising expenses turned a deficit into a profit for the Chicago mail-order house of Spiegel, May, Stern & Co. After severe losses during the depression, the concern reorganized its sales plan. It cut down the number of catalogs mailed to prospective customers from 2.7 million to a more selective list of 1.8 million. It concentrated its efforts on lines with the greatest profit margins, and it refused orders under $5. This policy of selling more goods to fewer customers helped to turn a loss of $300,000 in 1932 into a profit of $1.3 million in 1933.[4]

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[1] John Hall, *Jewelry Distribution by Wholesale Jewelers*, U.S. Bureau of Foreign and Domestic Commerce (Washington, D.C., U.S. Government Printing Office, 1933), Part I, p. 49.

[2] J. W. Millard, *Analyzing Wholesale Distribution Costs*, Distribution Cost Series No. 1, U.S. Bureau of Foreign and Domestic Commerce (Washington, D.C., U.S. Government Printing Office, 1928), p. 11. Based on data of the Western Electric Company.

[3] S. L. Kedzierski and C. E. Hughes, *Meeting the Small Order Problem in the Confectionery Industry*, U.S. Bureau of Foreign and Domestic Commerce (Washington, D.C., U.S. Government Printing Office, 1933), pp. 8–10.

[4] *Time*, Dec. 14, 1936, pp. 76–78.

Analysis of his business by one electrical products distributor showed that 309,000 orders out of 772,000, or 40 per cent, averaged over $25 per order. The average profit on these was $10.12 per order, while orders under $25 showed an actual average loss of $1.64 per order.[1]

Although selling small accounts and accepting small orders are frequently expensive practices in an otherwise profitable business it is not necessary to conclude that the only remedy is to eliminate the small customer. As Professor Elder says:[2]

> The answer to the small account, small order problem is not always to drop the small customers. Sometimes they can be made profitable by a special method of handling them. Dennison has installed a small order department which solicits business by mail from customers too small or too isolated for salesmen to call on. The Western Electric Company does not decline small orders, but handles them by a different routine which involves only about 25 per cent of the usual clerical labor. The scattering market involves in the aggregate a tremendous volume. The man who can work out a method for selling goods economically to the 50 per cent of the population living in towns of less than 25,000 population will make millions.

C. POOR MANAGEMENT IN RETAILING

Our system of free competition insures the right of anyone to enter business whether he is qualified or not. A relatively small amount of capital is required to start a retail business. As a result thousands of store owners poorly equipped by background, training, and financial resources have been brought into the field. Because of these fundamental deficiencies and because of the small amount of business available for the vast majority of newcomers, the death rate of small stores is enormous.

Retailer Mortality

The average life of American business concerns, inclusive of manufacturers and wholesalers, is only five years. Although separate and comprehensive data are not available for retailing alone it is safe to conclude that the life expectancy of retailers is certainly no longer—and probably shorter—than the average for business in general.

A number of detailed studies[3] of retailer mortality have been made over the last twenty-five years. All of them show the seriousness of the problem. In Pittsburgh, for example, between 1925 and 1934, an average of 20 per cent of the grocery stores studied by Professor Boer went out of business every year. In other words, one out of every five stores in business at the beginning of a year passed out of existence before the end. Of course new entrants came into the field, so that the total number at the end of the year was about the same as at the beginning. The annual mortality rates in the shoe, hardware, and drug trades were respectively 16.3 per cent, 10.1 per cent, and 9.4 per cent.

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[1] Reported by Domestic Distribution Department of the Chamber of Commerce of the United States.

[2] Letter from Robert F. Elder, Feb. 17, 1939.

[3] These studies are reviewed by Paul H. Nystrom in the *American Marketing Journal* for April, 1936, and by A. E. Boer in *The Journal of Marketing* for July, 1937, pp. 53, 54.

In a comprehensive study[1] made in Buffalo for the period from 1918 to 1928 the ranking of these four trades was the same, but the percentages of mortality were higher than those in the Pittsburgh study. The mortality of grocery stores was 35.9 per cent; shoes, 21.8 per cent; hardware, 16.2 per cent; and drugs, 12.6 per cent. These were sample studies, however, and the difference in the figures may be the result of somewhat different methods of research.

The first year in business, of course, is the hardest. Of the grocery stores studied in Pittsburgh, nearly 47 per cent were unable to complete one year of life. Nearly 40 per cent of the newly opened shoe stores went out of business before the end of one year, while the "infant mortality" of drug stores was 31 per cent, and of hardware stores, 28 per cent. In three out of the four trades in Buffalo it was somewhat higher.

These figures show withdrawals from business, not necessarily failures. Business may be discontinued for many other reasons than failure, such as death, ill health or retirement of proprietors, loss by fire, or changes to other lines of business. But Professor Nystrom estimates that only about 25 per cent of the withdrawals are due to these miscellaneous causes. Most, or all, of the remaining 75 per cent must be due to failure.[2]

He also states that the rate of failures according to the various causes were about the same over a forty-one-year period. Direct competition with other stores, popularly thought to be a common cause of failure, accounted for a little less than 3 per cent of all the failures reaching the bankruptcy courts in 1931. Furthermore, failures due to competition do not seem to change much irrespective of prosperity or depression. He concludes that a very large part of all business failures are due to poor management, even though ascribed to undue competition, changes in business conditions, lack of capital, or other reasons. In most cases these are only symptoms of the more deep-seated difficulty of weak or poor management. Parenthetically it may be said that such terms as "competition" and "poor management" are relative and not subject to strict definition. It would be very difficult to determine the causes and degree to which each is responsible for a failure.

Retailer mortality entails a heavy loss for the economic system. Not only is the capital of proprietors wiped out but losses are also often sustained by creditors. In addition to direct money losses are many other undesirable effects. For example, stable competitors are injured by the fact that failing proprietors cut prices in an effort to stave off the evil day; and then, when the business is closed out, the inventory is often sold at sacrifice prices.

Tangible Improvements

Concrete evidences of poor management in retailing are almost too numerous to mention. Among the more apparent are poor location of stores, bad layout, display and lighting, improper selection of merchandise, slow turnover of stock and inadequate inventory control, excessive credit losses, losses from returned goods and costly services, poorly trained personnel, inefficient advertising and promotion, improper pricing policies, and last, but most general of all, inadequate knowledge of costs.

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[1] E. D. McGarry, *Mortality in Retail Trade* (University of Buffalo Studies in Business, No. 4, 1930), p. 52.

[2] Nystrom, *op. cit.*, pp. 150–154.

Studies by the Department of Commerce and other agencies reveal many instances of these sources of high costs and show the savings which have come from intelligent efforts to reduce them. The *Louisville Grocery Survey*, conducted by the Department of Commerce in cooperation with the grocery trade, developed various improved merchandising methods which have been of great help to the grocers there and elsewhere. It was found, for example, that many stores were clogged with slow-moving goods. This retarded business, tied up capital and increased expense. To quote from a summary[1] of results from improving merchandising methods in this respect alone:

> A direct result of inventory improvement reported in one store was to jump sales from $80,000 to $96,000. Another increased its volume 20 per cent. A third store maintained business at the former level but handled it with reduced expense. A fourth, though suffering a drop in sales due to general conditions, has been able to ring up profits at the normal rate. One store which lost money during the survey has since, by improved operation of its meat department, become able to meet all competition and turn a net profit.

In discussing the work of this survey in general and its results for local storekeepers, the Louisville Board of Trade made the following comment[2] some time after the completion of the survey:

> A recent check-up showed wholesale and retail grocers in this territory are profiting greatly by putting into practice fundamental marketing principles developed by it. Many grocers have changed the outside appearance of their stores, have installed proper lighting and shelving fixtures within and have learned to make acceptable goods accessible. They are now taking inventory and keeping up-to-date records, which they had not done previously; they have learned how to analyze the cost of handling individual commodities and customers' orders to the end that they maintain smaller inventories, turn them over more frequently and are gradually eliminating unprofitable items and customers. Credit practices are being improved markedly. In fact the *Louisville Grocery Survey* has made known to hundreds of our tradesmen the essentials of successful merchandising and has brought to them inestimable benefits.
>
> It is significant that during 1929 fifteen groceries were forced into bankruptcy while in this first full year following the Survey only four suffered a similar fate, in spite of the most severe financial depression Louisville has experienced in a generation. We believe this remarkable improvement during these very trying times to be a direct result of the Survey.

A survey conducted in Alabama by the Department of Commerce[3] in cooperation with the University of Alabama showed a close relationship between efficiency and profits on the one hand, and proper store arrangement and display of goods, adequate record systems, and modern merchandising systems, on the other. This study covered various kinds of retail business. The report of the survey makes the following among many interesting comments:

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[1] *Aids to Retail Grocery Profits*, Domestic Commerce Series, No. 71, U.S. Bureau of Foreign and Domestic Commerce (Washington, D.C., U.S. Government Printing Office, 1933), p. 3.

[2] Letter to the Department of Commerce.

[3] F. K. Hall, *Survey of Retail Management Practices*, Domestic Commerce Series No. 81, U.S. Bureau of Foreign and Domestic Commerce (Washington, D.C., U.S. Government Printing Office, 1933), p. 78.

> As examples of extremely poor business methods encountered, it might well be pointed out at this time that eight merchants were found who had never taken a physical inventory of their merchandise, or else had not done so for several years. From information obtained, it was indicated that all of these merchants were losing money. It was also found that eight merchants had never prepared a financial statement of their business. Seven of these were losing money and the other was just breaking even. The fact that practically none of these merchants was making money is direct evidence that unintelligent business methods go hand in hand with poor business.
>
> . . . .
>
> It is not surprising that 83 per cent of the profitably operated stores kept well-up-to-date accounts, and that 88 per cent of the proprietors were able to locate without delay the detailed information required by the questions asked by the reporter.

The examples cited above can hardly be regarded as typical of conditions prevailing throughout the retail business, but they undoubtedly reflect factors responsible for widespread inefficiency and failure among retailers. Students of distribution as well as the leaders in retail merchandising agree that one of the prime causes of waste and loss in retailing is the lack of training and incompetence of the individual merchant.

D. POOR PLANNING

High selling costs are sometimes due not so much to inefficiency in performing distributive operations as to attempting an impossible task. If the product is poorly designed, inherently weak, or ineffectively packaged, or if the market is too small to support the needed organization, distribution is bound to be costly. Although distribution deals with many imponderable factors, unnecessarily high costs are often incurred which could have been avoided by adequate planning in the light of easily obtainable facts.

The waste in trying to market something that people do not want—or cannot be made to want—reflects a fundamental failure on the part of management to size up the desirability of its product. For example, an inventor developed a clothing accessory which he believed would have a large market if consumers were acquainted with its merits. When clothing manufacturers were approached with the suggestion that they incorporate the device in their garments, they denied its general appeal and refused to buy. The owners of the patent then decided to build up consumer demand and thus indirectly force manufacturers to use the product. Thousands of dollars spent on advertising were wasted, however, since the product did not have inherent appeal and consumer demand could not be created. If a fraction of the money spent on advertising had been used to determine consumer reaction before the product was put on the market, this waste might have been avoided.

A food manufacturer added a new line of products comparable with that of a competing manufacturer who had made a success in the field. The new product was unsatisfactory, however; it spoiled more readily, was not as attractively packaged as his competitor's, and sold at a higher price. In spite of the obvious disadvantages of his product he attempted to promote larger sales by advertising direct to the consumer. But advertising was not enough. It could not offset the fundamental deficiencies of his product and enable him to market it profitably.

A careful cost and market analysis by a large jobber of a women's apparel accessory revealed a whole series of wastes which had brought the company almost to bankruptcy. The firm had carried 230 designs of this accessory; but the analysis disclosed that 80 per cent of its sales and a still larger share of its profits were accounted for by 30 of these designs. It was also discovered that losses involved in trying to cover certain territories ate up the profits made in other territories. Unprofitable territories as well as many unprofitable small accounts were abandoned, with favorable results. Increasing the volume of sales normally reduces costs, but increasing the number of too costly sales obviously does not.

Knowing the Market

Even though a product has consumer appeal, is attractively packaged and satisfactorily priced, a selling program which does not rest on a thorough knowledge of the market is likely to be costly. A sound selling program requires an analysis of the buying habits of purchasers—the time, quantity, and frequency of their purchases. Moreover, the characteristics of the potential users must be determined. What is their purchasing power, occupation, age, sex, taste, and education level? To what size family do they belong, what income class, what language or racial group? Where are they located, in town or country, and in what region of the United States? And lastly, in what trade areas and from what sources do they buy? All of these facts are essential to sound planning in marketing a new product.

Progress toward the solution of these problems is being made. Research methods for determining consumer reactions and acceptance in advance of adding a new item to the line have been developed, and many manufacturers never try to market new products without pre-testing them. By establishing sales quotas through market and statistical research many progressive manufacturers and wholesalers are able to establish a factual basis for sales and advertising budgets. Current or periodic analysis of sales makes it possible for such distributors to keep a continuous check on the efficiency of their efforts.

E. PRICE POLICIES

The price policies of most manufacturers and distributors follow a conventional pattern. In the case of manufactured goods, uniform percentage mark-ups are often applied to cover all expense and profit except direct factory costs. Because it costs twice as much to make one article as it does to make another, it seems to be assumed that it will cost twice as much to distribute it. Actually, it may, or it may not. If it does not, the purchaser pays more for the product than he should. For him, at least, the cost of distributing that particular article, measured by the price he pays, is certainly too high.

Under this conventional mark-up system, for example, one dress may be priced at $19.75 and another at $39.50. Since the women who have $20 to spend far outnumber those who have $40, selling the lower priced garment involves less effort and expense. In the first case, . . . the woman pays $7.17 for the making of the dress and $12.58 for its distribution. In the second case $12.50 of the $39.50 purchase price goes for making the dress and $27 for distributing it.

Whether it actually costs more than twice as much to sell the better dress is something the retail merchant does not know. The chances are that the retailer is merely following a practice which will enable him to cover costs and profits in general, but which has no reference to the actual cost of distributing a particular article. Even if it does cost $27 to distribute the better dress, this only means that it costs that much to distribute it at the price quoted. What it would cost to distribute the better dress at a lower price, with the larger volume a lower price might evoke, is usually no more than guesswork. Conceivably the better dress could be sold in much larger volume and therefore with lower unit costs of distribution at the price of the cheaper dress. On the other hand, it is a well-known fact that many retail articles sell in better volume at a conventional price which buyers are accustomed to paying than they would at a lower price. The point is that little is known about the whole question of pricing policy.

As one department store official recently said:[1]

> We know that in both manufacturing and distribution too much pricing is wholly conventional and traditional, but we are not always willing to recognize the need for a more scientific approach to the problem of pricing. Too often we set a price first and then start out to find the facts or theories which justify our action. Correct pricing may be somewhat of an art, but there are few business arts which cannot be improved by scientific experiment and observation. The biggest job ahead of us in marketing is the promotion of a more intelligent art of pricing.

Pricing for the Market

Obviously an accurate knowledge of manufacturing and distributing costs is essential to sound pricing. The cost of making and selling a product is the long-run determinant of the price at which it can be sold. But other important factors may fix a price above or below cost plus a reasonable profit. A manufacturer or distributor selling a variety of products may introduce a new article at a price involving a temporary loss in order to expand consumption to a profitable volume. On the other hand, patents, the goodwill of a trade-mark, control of supply, or some other advantage may enable him to set a price which more than covers costs and a reasonable profit. Where demand falls off or an oversupply exists, goods may have to be cleared at a loss in order to reduce overhead or replenish cash reserves. On the other hand, a boom demand and shortage makes possible prices which yield more than normal profits.

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[1] Statement by Q. Forrest Walker, R. H. Macy & Co., Inc., at American Management Association Marketing Conference, New York, Oct. 23, 1935, published in *Consumer and Industrial Marketing*, Series No. 18 (New York, American Management Association, 1935), p. 30.

Competitor's prices for an identical or comparable product, of course, establish price limits for a product irrespective of its costs of production and distribution. Market conditions are so important in determining the possible sales volume at different price levels that merchandise managers frequently contend "that correct pricing cannot begin at factory door cost and 'work backwards' to the consumer price." Instead, it is claimed, market analysis must be employed to reveal the final price which will bring maximum sales volume. The product must then be designed to sell profitably at that price. But whatever the determinants of price may be, it is clearly essential that the manufacturer and distributor have a detailed knowledge of production and distribution costs—if for no other reason than to eliminate an unprofitable article or to redesign it.

Lower Prices and Higher Sales

The social and economic desirability of passing on to the consumer in the form of lower prices the fruits of business economies has recently been emphasized by the studies of The Brookings Institution.[1] It is futile to argue of course that under a competitive system, with self-interest the guiding motive, the price of an article should be reduced for the general welfare. The manufacturer or distributor cannot be expected to set a price to yield less than maximum profit on his entire volume. Nor can he be expected to lower prices unless he expects them to result in a larger volume of sales and an increase in his total profits. But the dead hand of traditional and orthodox pricing may prevent the individual businessman, or indeed an entire industry, from realizing where self-interest really lies.

Competition is supposed to bring about a close adjustment between costs and prices. But the process of adjustment may be long delayed by the powerful influence of convention, inertia, and blind imitation. The businessman, no less than the consumer, is too often the blind imitator of what his neighbor does. Unreasoning conformity with the policies and practices of others in the trade is too often a substitute for imagination, knowledge, and initiative. A radical departure from "the line of least resistance" in pricing policies often results both in lower prices to the consumer and larger profits to the distributor.

Frederick B. Heitkamp, addressing the American Management Association, presented some vivid testimony from the sales of a single company on the effect of price reduction upon sales volume.[2]

a. Sales of a camp chair increased five times when prices were decreased one-third.
b. Fishing reel sales almost tripled when prices were decreased about 25 per cent.
c. Sales of thermos jugs increased six times when the price of the jug was decreased one-fifth.
d. Baseball sales increased 25 per cent when selling price was decreased 15 per cent.
e. Shoe sales tripled when price was cut one-third.

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[1] *Income and Economic Progress* (Washington, D.C., The Brookings Institution, 1935), Chap. VIII, pp. 117–127.

[2] Paper by Frederick B. Heitkamp before American Management Association Marketing Conference, New York, October, 1935, published in *Consumer and Industrial Marketing*, Series No. 18 (New York, American Management Association, 1935), p. 25.

f. Play tents doubled when price decreased one-fifth.

g. Outboard motor sales increased more than three times when the price decreased one-fifth.

h. Stencil duplicator sales almost doubled when the price decreased one-third.

i. Radio sales for one model increased one-third when the price was decreased 10 per cent.

j. One manufacturer shows a constant increase in sales volume in the face of seventeen price reductions in eleven years, the cost to the user going from $2.65 per pound to 36 cents per pound in gradual stages.

Such figures, of course, are not conclusive. It does not follow from the experience of one company that the total consumption, and therefore the total production and distribution in all these lines, was similarly increased. It is clear, however, that there is a demand for a vastly greater volume of things than the American people have ever bought. Although production may be so ill-directed as to result in more than is needed of certain products and the price of these products may fall below actual production costs, general overproduction has never occurred. The American market is and always will be far from saturation. But it can become an active market only as the price of goods and the incomes of the people are adjusted to full volume sales and consumption.

DISTRIBUTION COSTS AFTER THE WAR

BY MALCOLM P. MCNAIR

In every period of high prices the cost of distribution comes under fire. Or perhaps it would be more accurate to say that a certain underlying puzzlement and distrust about distribution costs which is always present flares up during times when a rapidly rising cost of living is pinching many pocketbooks. This uneasiness about distribution costs is almost as old as recorded history. No doubt it springs primarily from the intangible nature of these costs. The country housewife taking eggs to the local grocery store to trade for tea, coffee, and sugar never quite understands why the merchant should not allow her the full retail price of the eggs; like many another, she is unable to "see" the value added by the merchant's operations.

CURRENT DISCUSSION

The present period of high prices is running true to form. Criticism of the margins taken by distributors to cover their costs and profits is rife. Through the price controls now in effect, and also through its program for reconversion pricing, OPA quite clearly is seeking to squeeze the margins of distributors, especially retailers. It is particularly significant that many of the companies,

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Source: *Harvard Business Review*, Vol. XXIII, No. 3 (Spring, 1945), pp. 338–359. Reprinted by permission.

agencies, and persons who are engaged in postwar planning are making lower distribution costs either a cardinal objective or a basic assumption in their aspirations for high-level employment in the postwar economy.

DEMAND FOR LOWER DISTRIBUTION COSTS

Typical of the insistent demand for lower distribution costs in the postwar period are these propositions laid down by the manager of the marketing research department of the Firestone Tire & Rubber Company:

> First: the prime need in industrial postwar planning is to develop markets—in other words, to sell more goods.
>
> Second: the next most important need is to do so at lower distributive costs, so as to reduce prices and widen markets still further.
>
> Third: development of maximum markets at lowest distributive costs will require a caliber of marketing beyond anything which has hitherto been seen in this country.[1]

In similar vein an executive of the General Electric Company, addressing a postwar planning conference of retailers and manufacturers, flung a challenge to retail distributors:

> So I say efficiency will go up after the war. [We] are going to have less overtime, which affects cost very much. We are going to have better equipment for postwar production than we ever had before. With the help of gentlemen like yourselves, we are going to have lower distribution costs. We have got to have them. . . . The only way the customer can get advantage of the lower cost is to have a lower-cost economy right straight across the board. How we are going to get it I am not here to say; I don't know. I do ask your sympathetic cooperation and understanding in trying to create a distribution system with what we have, not a new system. The system we have has grown up under the basis of sound economics for a good many years. Create channels to the consumer and methods which will enable us to get these products to the consumer at the lowest possible cost.[2]

All this has a familiar ring—the perennial idea that distribution costs are too high and that somebody, sometime, somehow is going to do something about them.

VOICES IN SUPPORT OF HIGH DISTRIBUTION COSTS

But there is one new note to be heard today. Whereas in the past everyone quite willingly conceded that distribution costs were too high, now a few people actually are having the temerity to assert that there may be some justification for high distribution costs. Professor Taussig many years ago pointed the way to this line of thought when he remarked that the high cost of distribution represented fundamentally the high cost of consumer freedom, although no one seems to have pursued all the implications of his remark until recently. At the same conference of retailers and manufacturers referred to above, there was distributed a publication of the postwar planning committee of the National

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[1] T. G. MacGowan, *Post-War Marketing* (New York, Bankers Trust Company, 1944), p. 4.

[2] J. R. Poteat, speaking at a postwar conference sponsored by the National Retail Dry Goods Association at Absecon, New Jersey, Aug. 8, 1944. *Proceedings* of the Association, pp. 64, 65.

Retail Dry Goods Association which included this statement about the possibility of lower distribution costs:

> Any reduction in such costs can be achieved only through the employment of fewer people. Those retailers who can reduce costs probably will *not* hesitate to do so through any realization that such action may create unemployment. Nevertheless, at a time when our chief problem is to create and maintain employment, it is inconsistent to tell the retailer to employ fewer people so that planning organizations will have to find still more jobs to take up the additional slack.
>
> *The question of lower distribution costs is something to be given consideration after full employment has been achieved.*
>
> Meanwhile each retailer will employ directly, or indirectly, sufficient people to render the type of service required by the classes of customers he desires to attract to his store.
>
> This probably will mean reduced expenses for some retailers, a maintaining of former expense levels for others and, perhaps in certain cases, costs may even increase.[1]

Another and a more carefully reasoned approach to this point of view is presented in a recent article in *Harper's* by Hartley Grattan. In criticizing those who discuss postwar employment prospects entirely in terms of factory jobs Mr. Grattan says:

> It is high time . . . to hammer home to Americans these elementary facts:
>
> First, that it will be impossible for the factories of this country to employ more than a fraction of these millions of people in the production of peacetime goods.
>
> Second, that this fact is nothing to despair of. For if we are to have a healthy postwar economy, the first essential is that our workers be *properly distributed* among the various occupations which make up that economy; and the best distribution will be one in which *a smaller proportion of Americans are engaged in manufacturing*—not only smaller than now, but smaller than in the nineteen-thirties, before the war boom began—*and a larger proportion are engaged in the service industries.*
>
> Third, that our main attention must therefore be concentrated upon seeing that after the war these service industries are given every opportunity to expand.[2]

Although Mr. Grattan does not develop the point, it seems to be a logical corollary of his view that with a larger proportion of the working population employed in the service industries, which of course include the distribution industry as one of their most important components, the tendency inevitably will be for the cost of distribution, as contrasted with the cost of production, to become a higher percentage of the total cost of goods and services to the consumer.

These voices raised in support of higher distribution costs say in effect: the service and distributive trades are fundamentally of a different order from the manufacturing industries, and their contributions to the general social welfare are not to be measured by identical standards of efficiency. One does not have to embrace this view in its entirety or in all its implications to perceive that it does throw considerable light on the behavior of distribution costs in the past and also on their probable trends for the future.

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[1] National Retail Dry Goods Association Postwar Planning Committee, *The Importance of Retail Distribution in Any Plans to Create and Maintain Employment and a High Level of Prosperity in the Post-War Era* (New York, The Association, 1944), pp. 8, 9.

[2] C. Hartley Grattan, "Factories Can't Employ Everybody!" *Harper's Magazine*, No. 1132 (September, 1944), pp. 301–304.

Sixty Years of Rising Distribution Costs

To make an appraisal of future trends in distribution costs, we need an analysis of the trends which have already developed. Certainly one basic fact suggested by the evidence is that, underlying any purely cyclical changes, some influence or set of influences has, on the whole, been pushing up distribution costs during the last 55 or 60 years. Although our knowledge in regard to distribution costs prior to World War I in the United States, or for that matter in any country in the world, is exceedingly sketchy, we do have some fragmentary data. And for the period after World War I we have more satisfactory data, gathered in response to the spreading interest in distribution costs which followed that war.

It happens that we can trace the general trend in department store experience for the whole period. We have, for instance, the *History of Macy's of New York, 1858–1919*[1] showing operating expense data for the years 1888–1919. Then, beginning in 1920 and continuing up to the present, we have the study of department store margins, expenses, and profits by the Harvard Bureau of Business Research. Moreover, department store figures are significant, since retailing operations constitute the largest part of the total distribution costs of consumer goods and since the department store is itself one of the most important types of retailing outlet.

In the year 1888 Macy's operating expense figure was about 13.65% of sales. In 1899, 11 years later, this figure had advanced to 17.23%. By 1919 it was 23.93%. Other fragmentary data confirm these Macy figures. Further, although the *History of Macy's* does not give figures later than 1919, it is safe to assume from such general data as the Harvard Bureau's study that by the 1930's the Macy expense figure had penetrated the 30% bracket. Clearly the general trend of distribution costs is up.

There are, of course, some forces working in the opposite direction. The advent of mail-order houses many years ago apparently rolled back distribution costs to a certain degree. The same thing is certainly true of the initial development of chain stores; and by competitive pressure the results were transferred to some types of wholesaling, notably in the food field. Virtually within the last decade another roll-back of distribution costs has accompanied the growth of supermarkets among the ranks of independent and chain store food distributors. And other comparable developments have taken place in other fields of merchandising.

Furthermore, it must be remembered that in looking at a series of expense percentage figures for a period of years in any one trade, such as department stores, variety chains, or shoe stores, some part of an apparently rising trend may actually represent costs transferred from some other sector of distribution. For example, it is hard to say what part of the apparent rise in Macy's expense rate from 14% or 15% of sales back in the 1880's to probably 30% or more in the 1930's must be attributed to a gradual taking over by Macy's, in its cost of doing business, of distribution expenses that at an earlier time appeared as part of the cost of the merchandise itself. If the retailer waits for manufacturers to come to him, selling expenses of the manufacturers are included in the cost of goods to the retailer; they do not have to be covered by the retailer's gross margin. On the other hand, if the retailer seeks out manufacturers by sending his buyers all over the country or, indeed, all over the world, those buying and perhaps merchandise-carrying expenses are part of the retailer's cost of doing business and do have to be covered in his gross margin.

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[1] Ralph M. Hower, *History of Macy's of New York, 1858–1919* (Cambridge, Harvard University Press, 1943), pp. 258, 394.

A similar situation is encountered when one seeks to compare operating expenses of certain types of chain stores, say grocery chains, with the operating expenses of independent retailers in the same line: the chain figures include the cost of the wholesale function, which has been integrated with the retailing job in the typical chain organization. Therefore, the fact that chain grocery concerns may generally have higher expense rates than independent grocers may prove very misleading if it is not recognized that the comparison is incomplete until the costs of the wholesaling functions are either removed from the chain figures or added to the independent grocery retailers' costs.

Nevertheless, the sum total result for the whole period of the last 60 years seemingly has been an advance in the total percentage cost of distribution, that is, in the relative share of the consumer's dollar required to cover distribution costs as contrasted with the part required to cover production costs. There have been tendencies working both ways, but the ones thrusting distribution costs upward have been the stronger. These tendencies will be examined in more detail later, as a part of the analysis which follows.

EFFECT OF THE BUSINESS CYCLE

Although the general upward swing in distribution costs appears to be a long-term trend distinct from mere cyclical influences, it cannot be analyzed and understood at any given time unless we know whether the cyclical changes are running counter to it or reinforcing it. In other words, what is the relation between it and the level of general business activity? Here, in judging the effect of short-term cyclical phenomena on the future, we are, of course, particularly concerned with the pattern existing during the war, since that will be the point of departure for postwar performance.

For the purpose of this inquiry, we may profitably use department store general averages for the 15 years from 1929 through 1943. These figures are shown in Exhibit I. Not all the stores reporting over this period were identical, but sufficient continuity of reporting was maintained from year to year to make the figures adequately representative of the changes which were taking place.

EXPENSE RATE

If we look at the total expense rate (a figure which includes imputed interest on real estate and certain other assets), it is at once clear that the depression years of the early 1930's with their sharp declines in sales volume witnessed a very pronounced rise in the percentage cost of doing business—a peak just short of 40% being reached in 1932. Thereafter, with the sales volume again

EXHIBIT

GENERAL AVERAGES FOR DEPARTMENT

Groups and Items	1929	1930	1931	1932	1933	1934
Department stores:						
Number of reports	527	564	451	428	450	458
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Year-to-year change in sales	101.2	93.7	88.2	76.9	97.3	111.0
Gross margin	33.5%	33.3%	33.1%	33.1%	36.0%	35.6%
Total payroll	16.8%	17.3%	17.9%	18.7%	18.3%	18.0%
Real estate costs	3.9	4.3	5.1	6.5	5.85	5.4
Advertising	3.3	3.5	3.8	4.0	4.0	3.8
All other expense	8.3	8.8	9.1	10.3	9.95	9.3
Total expense	32.3%	33.9%	35.9%	39.5%	38.1%	36.5%
Net profit or loss	1.2%	*L.0.6%*	*L.2.8%*	*L.6.4%*	*L.2.1%*	*L.0.9%*
Net other income	3.1	3.2	3.8	4.0	3.9	3.5
Net gain or loss before federal income tax	4.3%	2.6%	1.0%	*L.2.4%*	1.8%	2.6%
Federal tax on income and excess profits	......	......	......	......	......	......
Net gain or loss after federal income tax	......	......	......	......	......	......
Returns and allowances	11.15	11.85	11.45	11.85	11.7	11.3
Total retail reductions	*	10.0	10.8	11.95	8.9	8.6
Specialty stores:						
Number of reports	85	85	70	73	75	86
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross margin	35.3	34.3	33.7	34.0	36.9	36.8
Total payroll	16.5%	16.8%	17.1%	17.6%	17.0%	17.3%
Real estate costs	4.2	4.6	5.4	7.1	5.8	5.5
Advertising	4.0	4.3	4.4	4.8	4.4	4.4
All other expense	8.6	9.0	9.4	10.1	10.2	10.0
Total expense	33.3%	34.7%	36.3%	39.6%	37.4%	37.2%
Net profit or loss	2.0%	*L.0.4%*	*L.2.6%*	*L.5.6%*	*L.0.5%*	*L.0.4%*
Net other income	2.7	2.4	2.7	2.5	2.6	2.7
Net gain or loss before federal income tax §	4.7%	2.0%	0.1%	*L.3.1%*	2.1%	2.3%

on a higher level, the total expense percentage hung in the vicinity of 35% or 36%, except for a slight rise to about 37% in the less active year of 1938. Then, in line with substantial sales increases, there was a rapid drop from 1941 on. By 1942 the expense percentage of 32.05% was slightly below even the 1929 figure; and the drop to 29.4% in 1943 carried the department store cost of doing business back to a lower percentage than any experienced since the late 1920's.

It should be pointed out that, for the year 1943 and in part of the year 1942, the drop in the expense rate was too sharp to be explained entirely on the basis

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* Comparable data not available.

† Because of the difficulty in establishing common figures for specialty stores with net sales of less than $300,000, the general averages for 1941 are based on specialty stores with net sales of $300,000 or more. Since these averages reflect the performance of the trade as a whole and are heavily influenced by the results of the largest firms, it is believed that the 1941 data are essentially comparable with those of the other years.

‡ For the year 1943 firms were asked to report the federal taxes on income and excess profits net of the 10%

I

AND SPECIALTY STORES: 1929–1943

1935	1936	1937	1938	1939	1940	1941	1942	1943
459	394	458	430	428	429	407	368	366
100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
105.0	111.8	104.4	92.9	105.4	106.4	117.4	112.4	116.3
35.9%	36.5%	36.4%	36.4%	36.9%	36.95%	38.2%	38.7%	38.4%
17.95%	17.4%	17.9%	18.3%	17.8%	17.55%	17.3%	16.75%	15.7%
5.05	4.65	4.55	5.0	4.7	4.45	3.95	3.6	3.15
3.8	3.65	3.65	3.75	3.6	3.5	3.15	2.7	2.4
9.1	9.2	9.9	10.35	10.3	10.2	9.9	9.0	8.15
35.9%	34.9%	36.0%	37.4%	36.4%	35.7%	34.3%	32.05%	29.4%
0.0%	1.6%	0.4%	*L.1.0%*	0.5%	1.25%	3.9%	6.65%	9.0%
3.4	3.3	3.5	3.6	3.5	3.5	3.4	3.1	2.4
3.4%	4.9%	3.9%	2.6%	4.0%	4.75%	7.3%	9.75%	11.4%
0.45	0.8	0.65	0.45	0.65	1.1	3.2	6.1‡	7.7 ‡
2.95%	4.1%	3.25%	2.15%	3.35%	3.65%	4.1%	3.65%‡	3.7%‡
11.25	11.8	11.75	11.45	11.4	11.75	11.35	9.6	7.95
8.0	7.05	7.35	7.7	7.1	6.85	5.9	5.55	5.2
122	93	113	99	93	90	61†	109	91
100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
36.8	37.1	37.0	37.1	37.8	37.5	38.35	38.75	39.2
16.9%	16.75%	17.2%	17.55%	17.6%	17.8%	17.3%	16.8%	15.8%
5.85	5.3	5.05	5.25	5.2	4.8	4.65	4.15	3.85
4.25	4.1	4.2	4.4	4.4	4.2	4.05	3.75	3.15
9.5	9.45	9.95	10.3	10.3	10.3	9.9	9.05	8.35
36.5%	35.6%	36.4%	37.5%	37.5%	37.1%	35.9%	33.75%	31.15%
0.3%	1.5%	0.6%	*L.0.4%*	0.3%	0.4%	2.45%	5.0%	8.05%
2.6	2.75	2.6	2.75	2.7	2.8	*	2.2	2.1
2.9%	4.25%	3.2%	2.35%	3.0%	3.2%	*	7.2%	10.15%

postwar rebate on excess profits taxes. For 1942, however, the firms were not requested to provide details on the rebate; hence the average tax for 1942 may reflect taxes before the deduction of such rebates.

§ Data on federal tax on income are not available for a sufficient number of specialty stores to make general averages possible.

Source: Harvard Business School, Bureau of Business Research, Bulletin No. 119, *Operating Results of Department and Specialty Stores in 1943*, by Stanley F. Teele, p. 5.

of sales increases and hence must partly be presumed to reflect such factors as government restrictions on delivery, credit, and other services, the reduction of some operations substantially to a skeleton level because of inability to obtain new employees, and the willingness of customers to put up with substantial inconvenience in order to acquire wanted merchandise. The evidence points to the conclusion that management in a large number of stores was sufficiently skillful to make these cost-reducing factors more than counterbalance the obvious added expenses arising from rapid employee turnover and the inferior quality of many new employees.

But certainly the clearest conclusion that can be drawn from Exhibit I is that the percentage cost of doing business exhibits marked cyclical variation. For example, the highest point of total expense in this table is 40% of sales in 1932; the lowest point, 29.5% of sales in 1943. Federal Reserve figures for department store sales in the United States show an index of 75 for the year 1932 as contrasted with an index of 168 for the year 1943.[1] That such an increase in sales should exert a noticeable influence on the expense rate is, of course, a natural expectation.

Differences in sales volume of course represent in part differences in the physical volume of goods handled at retail over the counters of department stores. But that is not the whole story. There is also a substantial element of price change involved. In 1943, retail prices of department store merchandise were much higher than in 1932. It is this price factor which, along with some other changing conditions such as the tendency to trade up or down, is chiefly evident in changes in the size of the average sales transaction. And it is the variation in the size of the average transaction which is peculiarly important in its effect of the percentage cost of doing business. Although an increased dollar volume of sales resulting from an increase in the number of transactions may have some effect on the operating expense percentages, it is not nearly so clear or so inevitable an effect as is exerted by an increased dollar volume of sales arising almost solely from an increase in the average size of the sales transaction.[2]

One fact, then, which can be positively stated about the department stores expense rate, and indeed about distribution expenses in general, is that a marked drop in the general retail price level will cause an advance in the percentage cost of doing business, whereas a substantial increase in the general retail price level will cause a drop in the percentage cost of doing business. That is one relationship that we can nail down definitely. An important corollary for retail management, of course, is that expense control ought at all times to utilize data on the dollars-and-cents costs per transaction and not rely merely on percentages of sales, especially when sales constitute a rapidly changing base.

GROSS MARGINS

But has the cyclical influence that is apparent in changing expense rates been carried through to gross margins? That is, have the changes in expense rates been reflected in the size of the spread between the net cost of merchandise and the net amount received in sales? If not, then the changes in expense rates have been cancelled by opposite changes of equal or greater magnitude in profits and taxes—the part of the consumer's dollar taken by the store, either for itself or on behalf of the government, after paying expenses—and there has been no carry-through effect on the distribution costs borne by consumers.

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[1] *Federal Reserve Bulletin*, December, 1944, p. 1223.

[2] This is a point which has been developed with particular clarity by F. H. Gibian of Sears, Roebuck and Company, in an article entitled "Percentages Debunked" in *The Balance Sheet* for November, 1944, published by the Controllers' Congress of the National Retail Dry Goods Association.

For the depression years from 1929 through 1932, the gross margin, or spread between cost and sales, remained remarkably stable as a percentage of the sales dollar; it hung very close to the old traditional markup figure of 33⅓% of the selling price. In 1933, however, a sudden jump took place from the 33% level to a 36% level, and thereafter for the years before the outbreak of war in Europe the 36% level was maintained with minor variations. In 1939 and 1940, and increasingly in 1941 and 1942, the gross margin percentage edged up, reaching a peak of 38.7% for the year 1942. Whether or not the slight decline from this peak registered in 1943 was significant cannot yet be determined.

Broadly speaking, department store margins over this 15-year period certainly were increasing. In analyzing these figures we must of course remember that these higher gross margins do not necessarily imply higher initial markons, i.e., higher retail prices as marked on the merchandise when first put up for sale. The same result could ensue from a drop in the percentage of markdowns, employee discounts, and stock shortages if carried far enough. In any event, the picture is clear that over most of the years following the bottom of the depression in 1932, while the expense rate has been falling, the gross margin percentage has been either stationary or rising.

Profits and Taxes

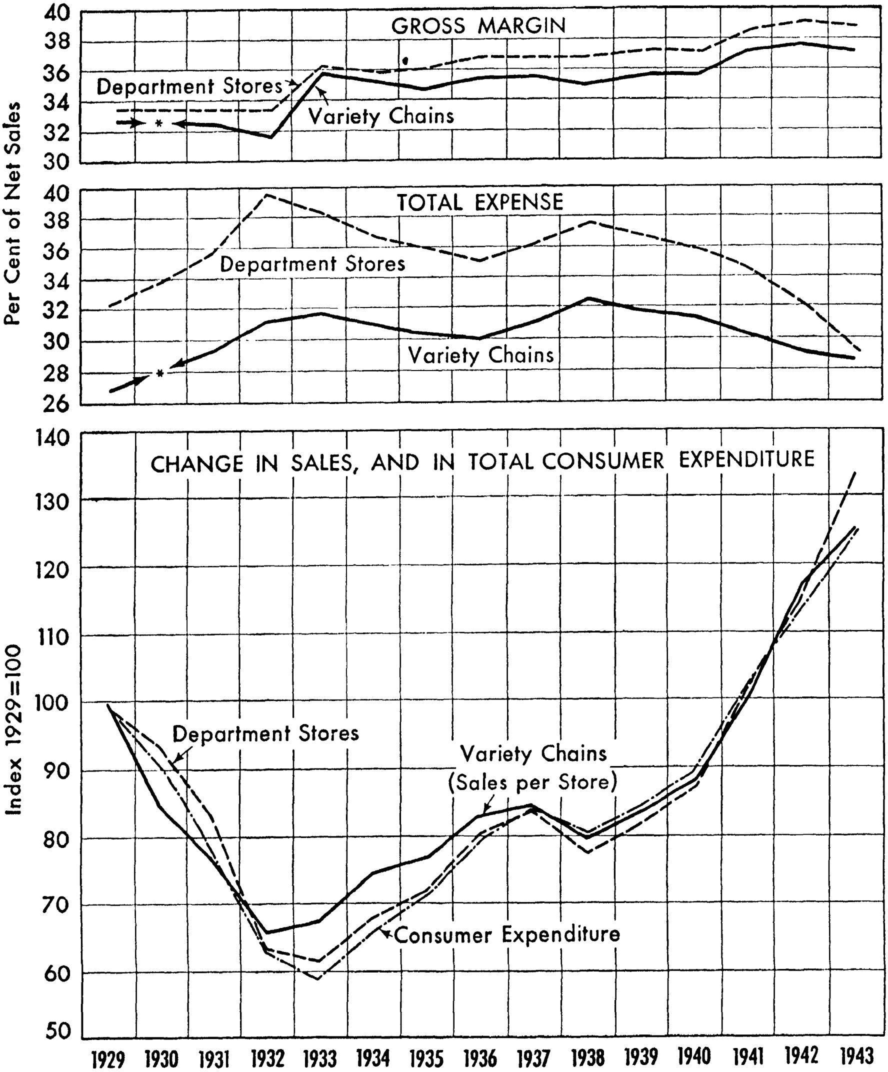
It is pertinent to ask what has happened to wartime earnings, in view of the falling expense rate and the stationary or rising gross margin percentage. The most significant earnings figures in Exhibit I are the so-called net gain or loss percentages (which include an adjustment for the imputed interest included in the total expense figure); taken as they are before federal taxes on income, they represent a pretty fair measure of operating efficiency. Net gain before federal tax on income did not reach a figure of as much as 5% of net sales at any time in the 15-year period until 1941; in fact, only in the years 1940 and 1936 did the net gain percentage exceed the figure for 1929. For the three years following 1940, however, net gain as a percentage of net sales scored a marked advance each year to figures of 7.3%, 9.75%, and 11.4% respectively. These are figures very substantially in excess of any previously recorded department store experience in this country—but they are, of course, figures *before taxes.*

The picture is entirely different *after taxes.* The extent to which department stores have been acting as tax collectors for the federal government, particularly during the war years, is indicated by the remarkable increase in the federal income excess profits taxes from about ⅔ of 1% of sales in 1939 to 7⅔% in 1943. Hence, percentagewise, the final earnings of department stores after taxes actually were lower in 1942 and 1943 than they were in 1941, and not significantly higher than they had been in 1939.

Perhaps the story on margins, expenses, and profits of department stores during the war years might be summed up by saying that in spite of a sharply decreasing expense rate brought about by advancing dollar sales volume and curtailed services, department stores evidently felt that they had to maintain their percentage gross margins at a high level in order to have a normal percentage of final net profit after meeting the unusually high income and excess

EXHIBIT II

MARGIN, EXPENSE, AND SALES DATA FOR VARIETY CHAINS AND INDEPENDENT DEPARTMENT STORES: 1929–1943



* Data not available.

General Averages—Harvard Business School, Bureau of Business Research, Bulletin No. 119, *Operating Results of Department and Specialty Stores in 1943*, by Stanley F. Teele. Consumer Expenditure—U.S. Bureau of Foreign and Domestic Commerce, *Survey of Current Business*, "Consumption Expenditures, 1929–42," by William H. Shaw. June, 1944. U.S. Government Printing Office, Washington, D. C.

Chart reprinted from Harvard Business School, Bureau of Business Research, **Bulletin** No. 120, *Expenses and Profits of Limited Price Variety Stores in 1943*, by Edward C. Bursk, p. 27.

profits taxes. In other words, the cyclical influence on the cost of doing business has been largely counterbalanced by the effect—psychological, at least—of unusually high taxes.

It is conceded that such a summary does not answer the policy question whether a combination of lower initial markon and smaller amounts paid out in excess profits taxes might not have been a wiser course for many stores to follow in a wartime boom. Our chief interest, however, in this examination of department store data on margins, expenses, and profits for the past 15 years is not in passing judgment on the policies followed by department stores during the war years, but rather in endeavoring to forecast what trends we should expect distribution costs to exhibit in the future. In confirmation of the department store data, it can be mentioned that studies of such a different operation as that of limited price variety chains show substantially the same results;[1] see, for example, Exhibit II where some of the figures for both department stores and variety chains are presented graphically.

COMPETITIVE FACTORS

Beyond the cyclical factors there are several other categories of factors which demand appraisal in any effort to formulate a realistic philosophy of distribution costs. The first of these is the existing managerial-competitive situation.

In the first instance, the cost of doing business in an individual concern, say a retail store, is directly related to the efficiency of the management. The evidence over a long period of years is incontrovertible that in situations where indices of good management are present, such as a rapid rate of stock-turn, a low percentage of markdowns, and the like, the individual expense rate tends to be low. In such concerns, with both the human organization and the physical plant effectively utilized, both the sales per person employed and the sales per square foot of space tend to run high; and the result is naturally a relatively low percentage cost of doing business. This is the state of affairs, let it be noted, within the individual enterprise.

The extent to which these conditions making for a low expense rate in the individual enterprise lead to a general low cost of doing business for the trade as a whole is another question. The answer depends most importantly on the state of competition. This means not merely competition at the retail level but competition throughout the whole structure of distribution, and even of manufacturing. In fact, even though competition at the retail level may be very keen, as it commonly is, the general character of competition throughout an industry or a number of industries may be such that the effect is not to decrease distribution costs but to raise them. For example, competition among manufacturers to obtain wholesale or retail outlets may easily result in the granting of larger and larger margins by means of various types of discounts, rebates, allowances, and so on. Then, having these wider margins to play with, the distributors, both wholesale and retail, tend to follow their natural desire to gain an edge on their competitors by enlarging their services to their customers in the way of free delivery, returned goods privileges, liberal credits, and the like. Thus the result of such competition is an increase both in gross margins and in percentage costs of doing business—what economists describe as "monopolistic competition."[1]

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[1] Harvard Business School, Bureau of Business Research, Bulletin No. 120, *Expenses and Profits of Limited Price Variety Stores in 1943*, by Edward C. Bursk.

No competent observer can doubt that there have been many instances of this type of competition in the United States during the last 20 years; and obviously, if this kind of thing is going on, the effect is to obscure to a considerable extent the competitive transmission of economies developed by capable managements in individual distributive enterprises. Therefore, in appraising at any time the outlook for distribution costs, it is important to try to decide whether the nature of competition is going to be such as to exert downward pressure on distributive margins or whether it is more likely to encourage wider margins accompanied by augmented costs for additional services or other methods of promotion.

LONG-RUN FACTORS

In any effort to go beyond immediate considerations in exploring the nature of competition, we become involved with a great variety of factors and inevitably come back to those long-run tendencies described earlier as working in both directions but exerting on the whole an upward pressure on distribution costs. Even though these long-run factors cannot be differentiated from the factors of competition with any degree of precision, they can be thought of most conveniently as making up a definite group of forces—the net effect of which has been the upward trend characteristic of the last 55 or 60 years.

TRANSFERRED PRODUCTION COSTS

Among these factors first place probably should go to what may be termed "transferred production costs," that is, distribution expense incurred in lieu of production cost. A small manufacturing concern distributing its product in a narrow local radius enjoys low marketing expenses but is not sufficiently large to realize important production economies. If over a period of years this organization expands to reach a much larger scale of operation, it will quite probably be able to achieve lower unit costs of production, but it will certainly incur higher marketing expenses in the effort to distribute goods over a wider geographical area.

Unquestionably, therefore, the growth of large-scale operation in American business over a long period of years has acted to tip the scale between marketing costs and production costs. Just before the war the best estimates recognized marketing costs as absorbing, by and large, somewhat over 50% of the total retail value of goods.[2] Although precise data are lacking for earlier periods, it is generally conceded that this figure is substantially higher than would have been a corresponding figure for less highly organized stages of the American economy. Of course what interests the consumer is the final price; and if a combination of 50% production cost and 50% marketing cost can yield a better value (i.e., better satisfaction) to the consumer than a combination of 75% production cost and 25% marketing cost, we should not become unduly worried about rising costs of distribution.

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[1] See Edward Chamberlin, *The Theory of Monopolistic Competition* (Cambridge, Harvard University Press, 1936).

[2] See Stanley F. Teele, "Logics and Emotions in Marketing," in *Business and Modern Society*, edited by H. T. Lewis and M. P. McNair (Cambridge, Harvard University Press, 1938), p. 306.

URBANIZATION

Also on the list of long-run factors which have tended to increase distribution outlays is the trend toward increased urbanization. In the retail field, at least, it is practically axiomatic that for a given size of retail business the percentage cost of operation advances as the size of city increases. Incidentally, this is one reason why comparisons of expenses for different sales volume groups in the retailing field without reference to size of city commonly show that the largest concerns have the highest expense ratios.[1]

The obvious items of cost which are affected by the population-of-city factor comprise delivery, taxes, and all the various expenses connected with a higher rate of customer credits for returned goods. There are also tendencies for both wages and advertising expense to be higher for stores situated in the larger cities. As a result of all these influences it is not rash to say that today in all probability the 100 million dollars of sales made by R. H. Macy & Co., Inc., under one roof at 34th Street in the heart of New York City could be transacted at a lower operating expense ratio if they were handled in 20 or 30 much smaller stores situated in suburban localities or smaller cities.

The extent to which similar factors connected with the size of cities are operative in wholesale distribution has not been established, but it is reasonably safe to assume that there is some analogy. Therefore the growth in size of American cities over the period since the turn of the century must be recognized as one of the long-run factors exerting upward pressure on distribution costs.

FASHION

The marked growth of fashion is another influence in the direction of higher distribution expense. Customers are more prone to return fashion merchandise for credit; losses from markdowns on account of errors in buying and seasonal changes are larger; and there is the necessity of carrying wider stocks of merchandise to afford a range for selection. As fashion has affected more and more types of merchandise, as the tempo of fashion change has mounted, and as fashion consciousness has permeated wider groups extending further down the social scale, these influences unquestionably have pushed distribution cost rates upward.

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[1] See Harvard Business School, Bureau of Business Research, Bulletin No. 119, *Operating Results of Department and Specialty Stores in 1943*, by Stanley F. Teele, pp. 22–24. See also Elizabeth A. Burnham, "The Department Store in Its Community," *Harvard Business Review*, Vol. XVIII, No. 4 (Summer, 1940), pp. 455–471.

SERVICES

It goes without saying that the substantial increase in the services offered to customers nowadays constitutes another reason for the advance in distribution cost percentages. Prompt delivery over a wide radius, liberal credit terms, almost unlimited return privileges, lectures, cooking and sewing schools, ticket bureaus, and so on, if not always actively demanded by customers, have at least been accepted with alacrity when competition has led to their being offered. Until the necessities of war intervened, there was no diminution in the growth of such services. Here and there, it is true, certain enterprises sought to capitalize limited service programs as a basis for low prices. On the other hand, during the 1930's an increasing number of the strictly cash merchandisers climbed onto the consumer-credit-installment-sales bandwagon.

Clearly, increased services to consumers are part and parcel of a higher standard of living, even though it may be questioned whether some of the service "frills" afford the consumer a genuine satisfaction commensurate with their real cost.

MANPOWER VERSUS HORSEPOWER

Another long-run factor exerting upward pressure on distribution costs is the disparity that exists between the field of distribution and the field of production with respect to technological development. It has frequently been remarked that, whereas goods are manufactured by horsepower, they are distributed by manpower. The output of the worker in the factory has been multiplied by the power of the machine, but a corresponding enhancement of per capita output in distribution by means of technological advances has not taken place. Aside from mechanical improvements in trucks, conveyors, escalators, cash registers, adding machines, and so on, used in the various facilitating functions of distribution, the main core of the job of transferring ownership of goods continues to be handled on a person-to-person basis. In retail distribution, for instance, the per capita sales (for the total number of employees in an establishment) do not show any particular tendency to increase, except for changes in the price level, in sharp contrast to the experience with output per capita in manufacturing industries.

Because the increased productivity of industry is at bottom the chief basis for the advancing wage level, and because distribution is at least to some extent in competition with manufacturing for its labor force, it is easy to see why stores are no longer able to obtain employees at such low rates of wages as were characteristic 50 or 60 years ago, when the Macy expense rate, for example, was under 15% of sales. This disparity between the technological status of production and the technological status of distribution would produce even more serious wage rate problems for retailers were it not for the fact that a shift of workers from manufacturing industries to trade and service industries has been occurring.

Census data indicate that in the United States in 1870 approximately 23½% of those gainfully employed were in trade and service occupations. By 1920 this figure had risen to over 40%, and by 1930, in the short space of 10 years, the quotient had again risen to over 47%.[1] This trend in itself is one of the most obvious ones contributing to higher proportional distribution costs. In considerable part, however, this shift of the gainfully employed workers into the field of distribution is not a separate cause from the trend factors enumerated above, but rather is itself a consequence of those factors.

Nevertheless, as indicated earlier, not all the developments during the period under review have pointed in the direction of higher marketing costs. When notable new types of distributive institutions have appeared, as for instance the mail-order house, the chain store, and the supermarket, they have quite commonly made their initial appeal on a low-price basis, and to sustain this appeal they have had to have certain cost advantages. What were those advantages? If one considers the three types of distributive enterprise just mentioned, and these clearly are the new institutional developments which have achieved the greatest prominence, it is not hard to discover that their cost advantages lie in two major principles: (1) the principle of functional integration, and (2) the principle of transfer of functions to the consumer.

FUNCTIONAL INTEGRATION

Chain stores illustrate the principle of functional integration since they commonly combine the functions of retailing with those of wholesaling. It is not so much the combination of functions under a single overhead that yields the economies, however, as it is the integration and smooth correlation of the two sets of functions under one management. This functional integration is best illustrated by the contrast between, on the one hand, a chain grocery concern with its closely knit organization of warehouse, delivery system, stores, buying organization, supervisors, district superintendents, and store managers; and, on the other hand, the counterpart of these functions as performed by an independent wholesale grocer with salesmen calling on thousands of retail customers, many of them small, and selling to each customer only a small proportion of his requirements. The advantage of the chain organization in terms of man-hours of time against physical volume of merchandise handled is very marked.

It is this principle of integration rather than any disparities in size (except in so far as large size tends to permit or facilitate integration) which constitutes the chief advantage that chains in the past have enjoyed over the independent wholesaler-retailer setup.

TRANSFER OF FUNCTIONS

The principle of transfer of functions to the consumer received its first prominent application in the mail-order business, generally at the hands of the large catalogue houses. By going to the work of obtaining a catalogue, studying it for the purpose of selecting items to be purchased, making out an order, paying in advance, waiting for the goods to be delivered, perhaps fetching them from the nearest railroad station, in some cases having to assemble knocked-down parts into the finished article, and possibly discovering that it had been necessary for the mail-order concern to substitute some other article for the one ordered, the consumer himself clearly incurs a considerable part of the marketing task, for which he receives compensation in the form of a lower price.

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[1] U.S. Bureau of Labor Statistics and Bureau of the Census.

This principle is an old one; but only a moment's reflection is needed to show that exactly this same principle is the one underlying the self-service operations in the modern supermarket. There the housewife must go to a store, trundle a carriage down the aisles collecting the items of merchandise which she selects, stand in line at the cash register perhaps for some minutes, pay cash, and carry the goods home. The lower price is a reward for doing part of the distribution job.

EFFECT ON LONG-TERM TREND

Both the principle of functional integration and the principle of transfer of functions to the consumer have yielded notable economies, especially in their initial application. Chain store prices in the period before the war generally ranged from 5% to 15% below prices of comparable goods in independent stores buying from service wholesalers.[1] The mail-order prices of goods sold by Sears Roebuck and Montgomery Ward are regularly lower than the prices of the same goods sold over the counter in the retail stores operated by the same companies. In the chain grocery supermarket there is a combination of both of the principles here discussed. A&P, for instance, has added notably to the distribution economies arising out of its chain form of organization by concentrating the greater part of its total sales volume through supermarkets, which have replaced at least four or five times their number of smaller stores. As a result the percentage cost of doing business for A&P registered a decline in the period just before the war.

It must be conceded, nevertheless, that after any institutional innovation in the marketing field has succeeded in reducing costs, and therefore margins, there is a strong tendency for the initial advantage to be gradually overcome by the encroachment of all those factors making for higher distribution costs which have been previously enumerated. In numerous chain store fields there is evidence that the cost advantages existing at an earlier date have been gradually narrowed over a period of years, because of trading up, offering of services, development of more elaborate stores and fixtures, and so on.

Altogether, then, the generalization may be essayed that, so far as the long-term trend is concerned, a majority of the underlying factors have operated in the direction of boosting the cost of distribution as a percentage of total consumer expenditures, but that from time to time this advance in marketing costs has encountered a setback from institutional innovations based on effective principles of cost reduction. In some instances such innovations may have achieved a lower distribution outlay for certain groups of goods; this is probably true of the supermarket chains in the grocery field, although it would be necessary to have a more complete analysis of the marketing costs of the food producers and processors who supply the supermarket chains before this assertion could be substantiated. Over the whole field of distribution, however, there have not been enough instances of the application of effective cost reduction principles to stem the tide of rising distribution costs for consumer goods in general.

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[1] See Malcolm D. Taylor, "Prices in Chain and Independent Grocery Stores in Durham, North Carolina," *Harvard Business Review*, Vol. VIII, No. 4 (July, 1930), pp. 413–424. See also U.S. Federal Trade Commission, *Chain Store Investigation* (Washington, D.C., U.S. Government Printing Office, 1932, 1933, 1934, and 1935).

Government Control Factors

Another category of the factors capable of exerting a marked influence on distribution's proportionate share of the retail sales dollar comprises government regulations and control of all types. The low expense ratio of 29.4% for department stores in 1943 presumably would not have been possible without the reductions in such services as delivery, credit, and customer returns which were sponsored by the government of the United States as measures of wartime economy and inflation control. On the other hand, although no specific figures can be cited, it seems probable that the price and rationing controls of OPA and the various "L" and "M" orders of WPB have operated to increase the cost of doing business to some slight degree, not only since these controls have given rise to definite tasks to which distributors have had to assign personnel, but also since the regulations have definitely circumscribed businessmen's flexibility and freedom of action.

It is quite conceivable, of course, that much more drastic controls for distribution, such as are not likely to be experienced in the United States or Canada, would have the effect of greatly lowering distribution costs. If consumers were required to stand in line at definitely specified times to receive strictly standardized shoes and clothing issued to them by government warehouses in the same way that the armed forces are supplied, no doubt distribution costs could be held to a low percentage figure. But that kind of strait jacket would be a fundamental reversal of the entire modern development under the free enterprise system to which Professor Taussig was referring when he identified the high cost of distribution with the high cost of consumer freedom. On balance, the wartime controls in both the United States and Canada, without resort to any really drastic measures, have tended temporarily to reduce distribution costs to a small extent.

Postwar Developments

There have now been identified certain major groups of factors which have an essential bearing on the percentage cost of distribution, namely the factors of cyclical change, the factors relating to the existing nature of competition, the longer-run factors which go to make up the pattern of social and business behavior over a considerable period, some exerting upward pressure and some exerting downward pressure, and the recently injected factors of government control. It is not suggested, of course, either that these groups of factors are the only ones involved or that they are entirely separate and distinct from one another. It simply seemed desirable to make this grouping as a basis for examination and discussion. It is now appropriate to consider the outlook for postwar developments in the same general framework.

CYCLICAL CHANGES

No one can successfully foretell the swings of the business cycle, in which price movements constitute so important a part. Nevertheless, wartime business cycles do present some pattern of similarity, and on this basis it may be judged that we are now somewhere on the upside of a wartime price inflation, an inflation, to be sure, which has been held under much better control than was its counterpart in the years 1914–1920 in the United States. A year ago there were indications that we might be close to the peak of the wartime inflation period in World War II, but events in the last four months of 1944 changed the outlook substantially and foreshadowed an increase in inflationary pressures. Prices, therefore, may go up somewhat more from their current position and may carry retail sales volume up with them. At the same time, however, there promises to be in the United States, at least, a considerably more marked shortage of consumer goods than has yet been encountered.

If the net result of these opposite tendencies should be a dollar sales volume in 1945 that is very close to the 1944 sales figures, there would be little change in the percentage cost of doing business. (Although the final 1944 figures are not at this writing available, the assumption is reasonable that they closely resemble the 1943 figures.) On the other hand, if the shortage of consumer goods should prove sufficiently serious to cause a decrease in 1945 retail sales, then the expense rate would be certain to rise, in which case 1943 and 1944 might prove to have been the cyclical low point in department store expense rates. All this is tantamount to saying that, so far as cyclical price factors are concerned, the cost of doing business in distributive enterprises is now at that low point commonly associated with a peak in prices and business activity, and is more likely, on the whole, to go up rather than down from this point, since it is clearly indicated in Exhibit I and Exhibit II that expenses as a percentage of sales tend to be at the bottom when prices and sales volume are at the peak.

How much the expense rate might rise in postwar years wholly in response to a downward cyclical movement is, of course, sheer guesswork. Probably the most that should be said here is that from the present cyclical position there arises a stronger presumption of a rising percentage than of a falling percentage, although it is the writer's personal opinion that in the United States inflationary and deflationary factors may be sufficiently well balanced in the early postwar years to prevent the cost of doing business in distributive enterprises from rising, in response to any cyclical downturn, to anything like the heights reached in the 1930's.

It must be remembered also that the behavior of the gross margin percentage is very important. No matter what the expense rate does or does not do, the effect on the consumer will be determined in part by the amount of profits and taxes set aside by distributive enterprises after paying expenses. It may very well be that federal taxes will need to remain at a high level for at least the first few postwar years; if this factor is put on top of a stationary or rising expense rate, the upward effect on over-all distribution cost will be accelerated. But if federal taxes are cut, particularly the excess profits tax—a not unreasonable political development—the distributors may be content with a smaller gross margin and thus absorb some or all of any increase in the expense rate.

In balance, considering the cyclical influences on expense rates in the light of what may happen to gross margins, the result is hardly likely to be a reduction in over-all distribution costs in response to cyclical factors, and at the same time there seems to be little need of fearing a precipitate rise. The reality is likely to be somewhere in between—in the form of a neutral, or perhaps a slightly upward, pressure.

COMPETITION

As indicated earlier, there is a strong suspicion that at least part of the advance in distribution costs in the past may be laid at the door of so-called "non-price" competition. This situation may not change rapidly, but there are some straws which point in the direction of greater intensity of price competition in the period after the war.

For one thing, a marked influx of new concerns into the field of distribution seems very likely. Many veterans, taking advantage of the terms of the GI Bill, will establish trade and service enterprises, especially retail enterprises. Furthermore, existing and new concerns in the small business category will receive strong support from the "small business" movement. The influx of such a large number of new entrepreneurs, many of them likely to be ignorant of their true operating costs, at first blush seems certain to enhance price competition.

Although enhanced competition may well be the net effect, the tendency in that direction will not be clear cut. It is already obvious that the small business movement in the United States, perhaps emulating the agricultural movement, will seek to protect small business in many respects from the ravages of price competition. We may even see "floors" for the prices of small business. It is true, of course, that large-scale distribution of the chain store type has predominantly exercised a strong influence in the direction of price competition, and that the importance of this type of distribution may be expected to increase gradually in the postwar period. Nevertheless, legislation sponsored by the small business movement, such as the Robinson-Patman Act, the Miller-Tydings Act, and the various state resale price maintenance laws, has already blunted to a considerable extent the weapon of price competition in the hands of the large-scale chain organizations.

Indeed, the present strength of the small business movement suggests not merely that such laws will not be repealed but rather that they will be given stronger enforcement. This is particularly true of the Robinson-Patman Act. And even though there is undoubtedly considerable sentiment in both the Department of Justice and the Federal Trade Commission in favor of repealing or nullifying the resale price maintenance measures, it may be safely predicted that the strength of the small business movement will prevent such a step and keep the measures active.

Notwithstanding the solicitude which the small business movement certainly will show for protecting the margins of small business concerns, it is fairly clear that government influence on the whole will be exerted on the side of price competition. OPA, as remarked at the beginning of this paper, is already moving strongly in the direction of narrowing traditional margins in order to reduce inflationary pressures. Likewise the Federal Trade Commission is actively concerning itself with distribution costs.[1]

The consumer movement is another influence in the direction of more emphasis on price competition and hence on lower distributive margins. Disregarding all the radical fringe associated with this movement, and even assuming that little headway is made with such problems as grade labeling, nevertheless the educational effect of the consumer movement undoubtedly will be in the direction of making consumers more alert to real values and thus enhancing the effectiveness of price competition.

Finally, the extent to which scrambled merchandising has developed during the war, i.e., handling of soft goods by automotive chains, sporting goods by tire stores, and so on, is likely to have the effect of increasing price competition. Many organizations apparently will make an effort to retain these expanded lines of merchandise which they have developed in the effort to hold sales volume during the war period, and this will mean an increased number of situations in which there will be a strong temptation to use the added secondary lines as "loss leaders."

Altogether, then, it seems likely that in the period after the war the scales are going to be tipped somewhat more toward the side of price competition, principally as a net result of government action and influence. With the various pressure groups that are operating, it is of course not to be expected that government policies will necessarily present a fully consistent picture, but this pressure on distribution costs is more likely to be downward than upward.

LONG-RUN FACTORS

In attempting to decide what will be the postwar effect of the group of long-run factors, we must again look at each of them separately.

The tendency for marketing costs to be incurred *in lieu of production costs* as concerns increase in size and seek wider markets is certainly not going to be reversed in the period after the war. Such cost transfers are primarily the result of the pressure of output; and with industry after the war feeling heavily the obligation to produce a large national product, there will be great pressure on marketing activities to handle the disposal of these goods. In fact, the tempo of marketing will have to be speeded up if anything, and the quality of marketing decisions will have to be substantially improved if consumers are to absorb the increased industrial output. Unless marketing activities show a high order of imagination, especially in the merchandising and promotion of new and additional goods, the marketing process is likely to become a serious bottleneck. Under these circumstances more and more companies will find their total budget of expenditures leaning more heavily toward the marketing side. There may not be present the same rate of acceleration in the shift of costs from the production side to the marketing side as before the war, but it is not plausible to look for a reversal in this trend.

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[1] See U.S. Federal Trade Commission, *Report of the Federal Trade Commission on Distribution Methods and Costs* (Washington, D.C., U.S. Government Printing Office, 1944).

There is a definite possibility that the effect of *urbanization*, a long-run factor which has contributed notably to higher distribution costs, is about to be reversed, or at least to lose its momentum. In fact the evidence was appearing even before the war. Large cities were losing population from the downtown areas to the suburbs, and retail trade was growing rapidly in suburban shopping centers. The department store branch movement was well established before the war; with the resumption of normal transportation conditions after the war, accelerated activity in the establishment of such branches is to be looked for. As suggested earlier, there is a strong possibility that this partial decentralization of some of the types of large retail business which have been predominantly located in central metropolitan areas will produce lower operating expenses.

Fashion changes have to some degree been held in abeyance during the war period, but there is every reason to expect a burst of renewed fashion activity as soon as the war ends. It is safe to predict that the same general tendencies will be in evidence, namely, increased tempo of change, more rapid geographical spread, influence on more and more types of consumer goods and even of industrial goods, and greater growth of consciousness of fashion at the lower levels of the social scale. Certainly with airplane transportation and television coming so prominently into the postwar picture, the influence of fashion in the future, as in the past, is going to be on the side of higher distribution costs.

We may be certain that the end of the war will witness a sharp reassertion by consumers of their basic demands for *services*. Indeed, thus far in the war effort, deprivation of services has been about the only approach to hardship suffered by consumers. Even though some merchandising executives in the postwar period will doubtless seek to preserve for a time some of the local understandings with fellow merchants concerning curtailment of services, the competitive pressure to break down such understandings will be very strong. Many of the types of services which stores have curtailed during the war years are definitely part of the higher standard of living which Americans demand, and after the years of deprivation the demand will not be long denied.

In connection with services, about the only consideration which points in the opposite direction is the possibility that consumers will gradually develop clearer concepts of what services they really require and which ones they are willing to forego at some saving in price. During the war many housewives have become so accustomed to carrying their own parcels home from stores that in the future undoubtedly some of them will continue to patronize stores which do not offer delivery service. Perhaps more important in the long run is the possible effect of the educational aspects of the consumer movement in making high school graduates more competent to select merchandise effectively and more cognizant of the costs involved in various special services. On the whole, however, the conclusion must be that the demand for services after the war will again be one of the long-run factors pushing distribution costs upward.

It would not be surprising if the years after the war witnessed some notable *technological* changes in distribution. In many respects such changes are long overdue. Quite possibly some of the officers and men who come out of the Army and Navy supply services to join the ranks of distribution, after wartime experience in handling enormous quantities of goods rapidly, will have some of the qualities of imagination and disregard of precedent that are needed to start the ball of technological change rolling more rapidly in the marketing field. Even without any effort to reduce the main functions of distribution to anything like a mechanical vending basis, there is still much room to make stores more efficient "machines for selling." Store architects and designers of fixtures have an important part to play in such developments.

A powerful factor pushing in the direction of increased technological efficiency in distribution will be the continued trend toward unionization in the retail and wholesale fields. Just as the wage demands of organized labor have forced manufacturers in the direction of technological improvement, so the increased trend toward unionization in distributive occupations may have a similar consequence.

And yet there are distinct limitations—perhaps fortunately from the standpoint of total employment, at least in the nearby future. Increased personal services are part and parcel of a higher standard of living. A machine is not a substitute for a skilled hairdresser, and no matter how many auxiliary appliances and gadgets a hairdresser may utilize, still his output of permanent waves per year is not going to increase; in fact, the larger the number of appliances and gadgets, the more the output is likely to decrease. There is, therefore, an important respect in which the trade and service industries never can be on the same footing with the production industries. Increasing demands for personal service will clearly impose limits on the extent to which technological advances in distribution can accomplish a lowering of distribution costs.

An inescapable corollary of the foregoing is that the trend for a larger proportional employment of people in the trade and service industries and a smaller proportional employment in the manufacturing industries is going to continue.

As a rough *summary*, then, of the outlook for those long-run factors that have been exerting an upward thrust on distribution costs, it seems safe to say that most of them will continue to operate in the same direction, though perhaps at not quite the same pace as in the past 50 years.

We can now turn to the other side of the coin and look at the future prospects of those few tendencies which in the past have exerted some influence in opposing the tide of rising distribution costs.

There is every certainty that *new marketing institutions* and new modifications of existing institutions will appear in the years that lie ahead. The supermarket department store, for example, representing an application of much the same principles and procedures that have been successful in supermarket food stores, is a strong probability. Roadside stores unquestionably are only in the beginning of their development. The same certainty is true of the whole area of innovations in quick-frozen foods, locker plants, and so on. Possible revolutionary developments in housing, which so many observers expect, may result incidentally in the emergence of new institutions and channels for merchandising household equipment and perhaps home furnishings in general. There is no way of telling what form these various new institutions will take; but we may be fairly certain that there will be such innovations and that they will make, in some instances at least, successful applications of existing or new principles of marketing cost reduction.

In this connection the question of the future of consumer cooperatives comes naturally to mind. But in the United States, at least, this is probably more a political question than an economic question. Yet, on the economic side, if the development of competition continues to be largely of a nonprice character, if institutional innovations do not appear in sufficient numbers or do not make sufficiently successful application of cost reduction principles, then consumer cooperatives are likely to assume a more important position.

There is every reason to think that the possibilities of *integration* as a cost-reducing principle are far from exhausted and that new applications will appear in the postwar years. Up to this time the chief applications of this principle have appeared in combinations of the retailing and wholesaling functions. There are more and more instances, however, in which this same principle is being successfully applied to the relations between distributors and manufacturers.[1] For example, there may be cited the voluntary arrangements which have existed for a number of years between the John Wanamaker stores and a number of furniture manufacturers, by means of which the total distribution cost of furniture has been pared down. Perhaps in most instances the application of the integration principle at the level of manufacturer-distributor relationships will take the voluntary rather than the corporate form. In any event, the integration principle is valid and can be pushed farther; it will continue to exert a downward pressure on distribution costs.

The whole *self-service* program of the typical food supermarket doubtless has wider applications than have yet been explored, in such lines for instance as drugs and hardware. Yet it also has limitations with respect to the kinds of merchandise to which it is applicable. Modifications of this principle, however, may be expected to influence store layout and fixtures with beneficial effects on operating expense ratios for many kinds of goods which do not lend themselves to full self-service. Indeed, for some lines of goods this principle may be regarded as actually enhancing service by increasing the customer's satisfaction consequent on her ability to see, handle, and select merchandise. A facilitating line of development in this connection, which has not yet progressed beyond the initial stages, is the use of informative labeling.

Self-service is built, of course, on the principle of shifting some marketing functions to the consumer. In the same connection mention should perhaps also be made of the variation of mail-order procedure which is represented by the so-called discount companies operating without inventory in cheap-rent offices. Indeed, in various applications this principle of shifting tasks to the consumer is susceptible of further exploitation in the future.

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[1] See Marvin Bower, "Cutting Distribution Costs through Integrated Cost Reduction," *Proceedings of the Sixteenth Boston Conference on Distribution* (Boston, Retail Trade Board, 1944), pp. 27–34.

In *summary*, the forecast may be hazarded that institutional innovations successfully applying cost-reduction principles will blunt and retard the impact of the factors pushing distribution costs up, but the long-run upward trend will continue to prevail.

GOVERNMENT CONTROL FACTORS

For this category of influences bearing on distribution costs the outlook in the United States, at least, is relatively clear. After the war the present controls will be abrogated, with the possible exception of some slight control over consumer credits maintained in the hope of thereby damping somewhat the fluctuations of business cycles. As matters stand today, the removal of the various government controls will have the effect of increasing distribution costs, since merchants will then be free to offer more services.

CONCLUSION

The sum total of the outlook for distribution costs after the war as surveyed under these several categories is that the percentage outlays required to move goods from manufacturers' inventories to consumers' hands will increase rather than decrease. With reference to cyclical factors, the expense rate is now at a low point, a position from which it is more likely to go up than down. The removal of governmental controls can only have the net effect of increasing distribution costs. There seems to be some likelihood that greater price competition in the future will exert pressure in the direction of lower margins and costs, although this situation is not clear cut. And with respect to those underlying factors which in the long run have been the principal determinants of distribution costs, there is no likelihood that social patterns will be altered in such a way as to reverse the long-run trend, although the upward slope of this trend in the future is quite likely to be less steep.

Is this a discouraging picture? Not at all. Society is receiving a product—a distribution and service product—in return for the increased costs which it is paying. This distribution and service product is no less real because it seems less tangible than the goods themselves. The question "Does distribution cost too much?" is fundamentally an unintelligent question, not directed to the real issue of how society can promote better living. And the position of those who argue that our economy is faced with disaster unless we can thrust distribution cost percentages down to a lower proportion of the consumer's dollar is not a tenable one.

Now, does all this mean that no one should seek to do anything about reducing the costs of any stages in marketing, or that we should subscribe to the apparent implications of the National Retail Dry Goods Association pamphlet cited at the beginning of this paper, to the effect that distribution costs should be tackled only after full employment has been achieved? Again the answer is certainly "no." *All* economies which do not impair the products that reach the consumer as goods and services, irrespective of whether they are economies in production or distribution, are desirable from the social standpoint. Such economies can be made to yield satisfactions in the form of additional goods, additional services, additional leisure, or additional culture. From an economic standpoint there is no distinction to be made between production and distribution as to the desirability of such genuine economies. Therefore we should go on striving for these economies at all times by all the means available without worrying whether the cost of distribution is too high.

And even though the general picture may be one of high or rising distribution costs, each particular trade must consider its own relative position. Any form of distribution that has a relatively high percentage cost of doing business is vulnerable to new institutional developments. For instance, department stores suffered a very serious drop in sales volume in the depression years after 1929, and it was not until 1939 that their total sales came back about to the 1929 level. During the same period, however, department store chains of the Sears, Ward, Penney type very greatly increased their total dollar receipts; and part of their success unquestionably was based on the effective application of some of the cost reduction principles discussed in the foregoing pages. Also, within any particular trade, studies of margins, expenses, and profits have long shown that the individual concerns earning the highest profits are predominantly those with the lowest expense rates rather than those with the highest gross margins. Certainly here is no basis for complacency on the part of distributive enterprises with respect to their cost of doing business.

DISTRIBUTION COST ANALYSIS

Cost Analysis in the Retail Store

The principal objective of cost analysis in the retail store is to help the merchant adjust his inventory and his merchandising efforts to sales possibilities so as to yield the greatest profit. The retailer typically is concerned only with commodity-cost problems, for usually he is not in a position to select his customers, his order sizes, or his territory (once he has located his store). He is, however, constantly confronted with questions concerning commodities.

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Judgments of Relative Profitability

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Mark-up Rates. Probably most merchants base their judgments of relative profitability on relative percentage mark-ups. Many comments are noted, in

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Source: Excerpts from U.S. Bureau of Foreign and Domestic Commerce, Economic Series No. 50, *Distribution Cost Analysis*, by Charles H. Sevin (Washington, D.C., Government Printing Office, 1946), pp. 6–24, 30–44.

the trade press and elsewhere, for example, that item A is "unprofitable" because its mark-up is only 6 percent while the average operating-expense ratio for the store or for the trade is 20 percent. Likewise, statements are seen to the effect that A is "more profitable" than B because it is sold at a mark-up of 15 percent compared with only 10 percent for B.

Judgments of relative profitability which are based on mark-up rates and average expense ratios can be very misleading. For example, in one grocery chain, tub butter with a gross margin of approximately 12 percent showed an apparent net loss of 5 percent on the basis of a comparison with the average expense ratio of 17 percent, while tub lard with a gross margin of 22 percent showed an apparent net profit of 5 percent.

After the chain made an allocation of expenses to commodities, however, the picture was found to be exactly the opposite. The expense rate for butter was 10 percent, which, compared with a gross margin of 12 percent, yielded a net profit of 2 percent. On the other hand, the expense rate for lard was 24 percent, so that, with a gross margin of 22 percent, lard showed a net loss of 2 percent.

This study also demonstrated that the average expense rate could not be applied indiscriminately to articles which vary widely in unit price. It was found, for example, that it cost almost the same amount—in cents—to handle a pound of lard as it cost to handle a pound of butter. The retail price of a pound of butter, however, at the time of the study was about three times that of a pound of lard, so that if the average expense rate were applied to each it would appear that the cost—in cents—of handling a pound of butter was three times as much as that of handling a pound of lard.

It was also found to be misleading to use a percentage rate in measuring the expense on the same item on two different dates, if the retail price fluctuated widely. For example, the price of a bag of flour might vary from a low of around 50 cents to more than $1 within a period of a few years. The actual expense of handling, in cents per bag, might be approximately the same at each retail price. Using a percentage rate, however, it would appear that it cost twice as much to handle flour when it sold for 50 cents per bag as when the price was $1.

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Turn-over Rates. Some merchants base their judgments of relative commodity profitability on turn-over, instead of mark-up, rates. For example, according to the turn-over basis of judgment, a commodity with an inventory turn-over rate two times that of the average inventory turn-over rate for the store as a whole has an expense rate half as great as the average operating-expense ratio for the business. Likewise, a commodity with a turn-over rate half as great as that of the business as a whole would have an expense ratio twice as great as that of the entire business. Other items would have expense rates in proportion. These expense rates are then compared with the commodities' gross-margin rates to determine relative profitability.

Although, in some respects, this turn-over concept is an improvement over the mark-up rate method for judging profitability, it has certain implications which are misleading. Under the turn-over basis of judgment, it is assumed that *all* the expenses of the retailer vary directly with the rate of inventory turn-over, or, what is the same thing, with the total dollar value of the average inventory. As will be shown below, however, not all retail costs vary with the average inventory value.

Under the turn-over basis of judgment it is further assumed that a single commodity accumulates certain costs with the passage of time, until, if it stays on the shelves long enough, these costs eat up the gross margin and the item becomes progressively more unprofitable. Thus, this assumption implies that the space and capital costs, which are related to turn-over, are variable with respect to a single commodity; that these costs stop accumulating when the commodity is sold; and that the share of these costs which is allocated to the individual commodity could be eliminated if that item were dropped.

This is erroneous, since these space and capital expenses are "fixed" costs in relation to a single commodity. Space and capital charges do, of course, accumulate with the passage of time, but only in the aggregate. From the standpoint of maximizing profits, the amount of these expenses for a given period of time, such as a month or a year, is the static factor, while the dollar gross margin earned by the commodity is the dynamic factor. In other words, the amount of expense related to turn-over which is allocated to a single commodity for a given period is a fixed expense which will be neither increased if the turnover of the item is stepped up nor eliminated if the item is dropped. Since these are fixed expenses, however, the net profits of the store will be enlarged if the dollar gross margin earned by that commodity or by some other commodity substituted for it is increased.

Ranking by Dollar Margins. The objective of maximizing profits could therefore be approached simply by ranking the commodities sold in the store according to their *dollar* gross margin, and replacing those bringing in the smallest dollar returns with others earning larger dollar margins. This would be a much better approach than to judge relative profitability on the basis of relative mark-up or turn-over rates or a laissez-faire attitude. Such ranking, however, would not indicate certain opportunities for maximizing profits which would be brought to light by the cost-allocation method outlined in following paragraphs.

For example, two commodities have the same dollar gross margin, and therefore appear to be equally profitable. One of these (item A), however, occupies twice as much shelf space and requires twice as great an inventory investment as the other (item B). The cost-allocation method (see p. 736) would indicate that item A is relatively less profitable than item B. The merchant might find that if item A were eliminated, the space and capital thus made available could be used for carrying two new items, C and D, so that the dollar gross margin obtained from items B, C, and D would exceed that formerly obtained from A and B.

Of course, the relative gross margins for commodities A and B could be ascertained, and their relative profitability in terms of their characteristics as regards use of space and capital could be determined by observation. But with many hundreds of items carried in stock in the typical retail store, this observation method would not be an easy task. Cost allocations would not impose a large additional burden of work—as compared with this dollar gross margin and observation method—and would have the advantage of providing a quantitative measure of relative profitability.

COST-ALLOCATION METHOD

A fairly simple method is needed for determining the relative profitability of commodities in retail stores so that the retailer can avoid the above-mentioned pitfalls of judgments which are based on mark-up rates, turn-over rates, and average-expense ratios. But to devise a simple, workable, and yet accurate technique is no easy task.

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Characteristics of Retail Costs. Certain characteristics of retail costs constitute one of the main obstacles to planning a workable and simple cost-allocation method. For example, in the short run, and in relation to the individual commodity, virtually the entire gamut of retailing expenses is both "fixed" and "common." The "variable" and "separable" expenses are usually of insignificant proportions. That is, most of the costs in a retail store, such as rent and wages, are incurred in common for the entire range of commodities carried in the store. Thus, if a single item were eliminated, practically no expenses would be reduced. Similarly, if a single item were added, total expenses would not be affected.

Another factor that affects cost-allocation methods is that important activities or functions in a retail store may, in normal times, be rather consistently under-utilized. Such evidence as is available (see discussion below), indicates, for example, that in the typical retail store the time of employees is not utilized to capacity as regards commodities.

In contrast to this condition, the facilities for carrying merchandise in stock are usually being utilized to capacity. This may be illustrated by raising the question, "Why doesn't a retailer add *any* new items that will yield *any* gross margin?" The retailer is, in fact, constantly besieged to do just that. Up to a point he might follow this course of action, but it is apparent that somewhere along the line, there are limits to the process.

In the typical retail store, these limits are chiefly imposed by space and capital. While there is generally room for one additional item and while credit would usually be available to carry that additional item, most stores work fairly close to the limits of effective display space and capital and credit utilization.

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Further, the maintenance of liquid buying funds enabling the merchant to take advantage of cash discounts and favorable buying opportunities in the market are important factors affecting the complete utilization of credit and capital in some lines of trade.

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True, the peak demand for customer service at certain parts of the day is a central factor in determining the number of clerks needed, so that there may frequently be an excess of clerk time available when few customers are in the store. Further, if selling activity increases sufficiently, the merchant may need to hire additional clerks to handle the peak load, even though there is idle time during slack periods with the lesser number of clerks.

But the selling activity which affects the number of clerks needed and the degree of utilization of their time is apparently determined by customer, rather than commodity, characteristics. That is, it appears to be difficult to trace any connection between the number of commodities carried in a store and the number of clerks needed to serve the customers coming into that store.

This becomes even more evident when attention is focused on the margin. That is to say, clerk time is not being utilized at or near capacity as regards the individual commodity in any store where the addition of one or a few new commodities or the elimination of one or a few old commodities does not affect total selling wages. Clerk time probably would be affected by a change in the number of commodities carried in the store only if an entire department or section were involved.

Where such a situation exists, selling wages are not allocated to individual commodities. This procedure is in accordance with the general principle that the costs of those functions which are not being utilized at or near capacity are not allocated to individual segments of sales, since these costs would not be affected by either substitution or addition of small segments of sales.[1]

Of course, in those stores where clerk time is being utilized at or near capacity so far as commodities are concerned, that is, where the aggregate amount of wages would be affected by the addition or elimination of one or a few items, clerk wages would be allocated to commodities. In larger stores having specialized personnel, for instance, it is more likely that the nonselling employees would be utilized at or near capacity in many instances, and their wages would be allocated to commodities.

Accordingly, the only expenses that would be charged to commodities in the typical retail store are the functional costs involved in the maintenance of and investment in inventory. These are, in the main, rent (or occupancy) and interest expenses. The amount of these functional costs that is allocated to a commodity is a measure of the use that commodity makes of the factors which are being utilized to capacity—use which prevents some other items from being carried.

Costing Techniques. The actual technique of this method of making a cost analysis in a retail store is as follows:

1. Space costs. For the purpose of allocating space costs, the total store area is divided into two major parts: (*a*) Merchandise-display and storage area, and (*b*) customer and service area. The latter consists of the space normally unoccupied by merchandise, such as aisles and check-out counters, which is used by the customers and by employees in serving customers. The cost of the customer and service area is not charged to commodities since the amount of space required depends on customer characteristics, such as the number of customers, number of sales transactions, and customer peak loads. In some stores, this area may occupy as much as 45 percent of the total store space.

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[1] E. R. Hawkins, *Distribution Cost Analysis* (mimeographed bulletin). U.S. Bureau of Foreign and Domestic Commerce, U.S. Department of Commerce (Washington, D.C., U.S. Government Printing Office, July, 1944).

The cost of the remaining area in the store—the space normally devoted to merchandise display and storage—can be allocated to individual commodities on the basis of the number of square feet of display and storage space occupied by or reserved for the maximum inventory of the item. (In some cases cubic feet would be a better measure than square feet.)

The total cost of the display and storage areas in the store divided by the total number of square feet devoted to such space gives a cost per square foot. This cost is then multiplied by the number of square feet of space utilized by the individual item or group of items.

For greater refinement, the relative selling values of different shelf and display locations in the store may be reflected in the space costs by a weighting which is established on the basis of experience and judgment. This weighting, however, is a rather difficult process.

Space costs include rent—or the equivalent building costs if the building is owned by the retailer—heat, and light. They also include depreciation of store fixtures and equipment, and miscellaneous store-maintenance costs.

2. *Inventory costs.* These can be allocated to individual commodities on the basis of their average inventory investment. The total inventory costs divided by the total average inventory value gives a cost per dollar of inventory value. This figure multiplied by the average inventory value of the individual commodity or group of commodities gives its investment costs, which consist of taxes and insurance on inventory and interest expense.

For greater simplicity, in those cases where the investment costs are very small, or where average inventory values of the various commodities do not differ substantially, the investment costs may be combined with the space costs and allocated together on the basis of space occupied. Or, where it is difficult to measure the space occupied by each item, and relative inventory values indicate relative space occupied by different items, the space costs may be combined with the investment costs and allocated together on the basis of average inventory value. Neither of these two procedures, however, would be as accurate as the one in which space and investment costs are allocated separately.

3. *Direct costs.* In many kinds of retail stores some expenses can be charged direct to specific departments, lines, or commodities. The depreciation, maintenance, and other costs of specialized fixtures and equipment, such as soda fountains, refrigerators, and coffee mills, can be traced directly to the lines or departments benefited. Special supplies and wrapping materials and taxes and licenses for specific commodities are other examples of direct expense items.

Although these expenses may be relatively minor, they should be charged direct whenever possible. In many cases it may be necessary to make subsequent allocations to determine costs for individual brands or items. For example, although coffee-mill expense is a direct cost of the entire coffee line, it would have to be allocated on the basis of the number of pounds ground to get costs by individual brands.

Relative Profitability. The total allocated and direct costs of carrying a commodity are subtracted from its dollar gross margin. Any excess represents the commodity's contribution toward the remaining expenses of running the store, and is also the measure of the item's relative profitability. The dollar amount—not a percentage rate—of this excess of margin over cost is the basis for comparison. Those items which show the smallest excess of dollar gross margin over allocated costs are relatively unprofitable. Such comparisons can be made for all commodities in the store, for the items within a single department, for groups of similar commodities, or for different brands of the same commodity.

Unprofitable Items. Items that are revealed as relatively unprofitable on the basis of these comparisons are tagged for remedial action by the merchant. Such action may take the form of substitution of relatively more profitable items, a change in the method of handling, or, in some cases, elimination.

Possibly, of course, the item must be handled despite a relatively low contribution because customers expect all stores to carry it, or for other reasons. But in such instances, the merchant may be able to relegate these commodities to less favorable shelf or display space or to reduce or eliminate merchandising efforts spent on them—reserving his space and efforts for items which show a relatively greater contribution to profits.

If substitution is feasible, however, the merchant will search for a new item that will yield a greater excess of gross margin over the allocated space and inventory costs than the old commodity which is to be dropped. If no such alternative product can be found, there is, of course, no point in eliminating the relatively unprofitable item, since the expenses allocated to the commodity are fixed costs and will continue, while the gross margin earned by the item would be lost.

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COST ANALYSIS FOR THE WHOLESALER

Although the basic techniques of distribution-cost analysis are the same in wholesaling as in retailing, their application is more difficult—a reflection of the more complex nature of wholesale trade as compared with retailing.

In the first place, the wholesaler has to make decisions in regard to customers and territories, as well as commodities, in order to maximize profits. Would the business be more profitable with or without certain customers? Would the business be more profitable with or without certain additional or presently covered territories? Should salesmen cover this territory more, and another one less, intensively? Would the business be more profitable with or without a certain group of brands or commodity departments? Should this brand be dropped and the efforts spent on it redirected to another? What is the minimum order size that it is profitable to accept? In answering such questions as these, distribution-cost analysis, together with measurements of market potentials, is a valuable aid.

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COST ANALYSIS FOR THE MANUFACTURER

The application of the basic techniques of distribution-cost analysis becomes even more difficult for the manufacturer than it was for the wholesaler and retailer. The basic procedures or steps involved, which will be discussed later, are outlined here:

1. The separable, or direct, expenses are measured and assigned direct to customers or commodities.
2. The common, or indirect, expenses are allocated or assigned to functional-cost groups.
3. The factors which measure the variable activity of the various functions are identified, and the amounts of these factors, in the aggregate, are determined.
4. A measurement is made of the share of the variable activity of each of these functional-cost groups which is utilized by the segment of sales whose cost is being measured.
5. The ratio of the share of the activity of the function that is being utilized by a segment of sales (step 4) to the total quantity of the activity of that function (step 3) indicates the portion of the cost of that function which is allocated to that segment of sales.
6. The excess of dollar gross margin over the sum of the direct expenses and the shares of the various functional-cost groups allocated to a commodity or customer or other segment of sales indicate its relative profitability.

DIRECT EXPENSES

In contrast to the usual situation in wholesaling and retailing, the separable, or direct, expenses of a manufacturer may constitute a significant proportion of the total costs associated with a specific segment of sales. This may be especially true of an organization engaging in extensive marketing activities, where separate sales departments are maintained for selling specific product groups and for soliciting specific customer classes.

In such an instance, if the primary-expense accounts are kept in sufficient detail originally, or if provisions are made for subsequent divisions or subclassifications of the primary-expense accounts, many selling expenses may be assigned direct to either a product or a customer class.

For example, when a single product group is sold through a single sales department to several classes of customers, the classification of the primary accounts by sales departments will automatically assign the expense to the product, and this expense can then be allocated to customer classes and to individual customers. Likewise, when several product groups are sold through a single sales department to a single customer class, the classification of the primary-expense accounts by sales departments will automatically assign these selling expenses to customers and the expense can then be allocated to products.

To illustrate, the sales department of a rubber manufacturer might be organized so that it contains many specific product and customer subdepartments as shown below.[1]

- Specific product solicitation departments:
  - Tire division
    - Pneumatic passenger casings and tubes
    - Pneumatic truck casings and tubes
    - Tractor and implement casings and tubes
    - Solid tires
    - Automobile accessories
  - Mechanical rubber goods division
    - Molded and extruded rubber goods
    - Printers' supplies
    - Conveyor belting
    - Hose
    - Packing
  - Heels and soles
  - Hard rubber
  - Footwear
  - Tiling
  - Rubber thread
  - Rubberized fabrics
  - Sundries
- Specific customer solicitation departments:
  - Original equipment or manufacturers
  - Dealers
  - Jobbers
  - National accounts
  - Commercial accounts
  - Mail order
  - Chain stores
  - Retail
  - Consumer cooperative
  - Government
  - Bus mileage

Direct charges to primary-expense accounts under each one of these subdepartments would be made wherever possible. This applies not only to such sales-solicitation expenses as salesmen's salaries, commissions, and traveling expenses, but also to such other items as advertising, transportation, packing, and shipping, which may be similarly subdivided. Also, it may be possible to further divide some or all of these sales departments into home office, district, and branch fields, so that there will be a direct charge of some expenses to territories as well as to products and customers.

Such a detailed classification of accounts and recording of expense items undoubtedly entails much additional work. It results, however, in less work in the allocation of common expenses and in more accurate analyses of distribution costs.

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[1] *Uniform Accounting Manual for the Rubber Manufacturing Industry* (The Rubber Manufacturers' Association, Inc., 1933).

FUNCTIONAL CLASSIFICATION

Although the proportion of direct costs may frequently be significant, the greater part of the manufacturer's distribution costs are likely to be indirect, as in the case of wholesaling and retailing. To facilitate their allocation, as well as for purposes of expense control, these indirect expenses are classified into functional-cost groups.

The basis of the functional classification which would be used by any given manufacturer is a study of the marketing activities performed by that manufacturer. It is important that the functional classification be sufficiently detailed so that the work performed in any one function will be of the same general kind. Such homogeneity facilitates the assignment of an entire functional-cost group by the use of a single factor of allocation, as will be described hereafter.

The classification of indirect expenses by functions is in many respects similar to the process of classifying direct expenses by sales departments. The difficulties encountered in both cases are similar. It is by no means as easy to determine outlay in terms of functions as it is in terms of the so-called natural-expense accounts. The difficulty lies in the fact that payments are often made simultaneously for the materials and equipment necessary to the performance of several functions. And when personnel performs more than one function in the regular routine of work, similar problems arise.

There can be little doubt that to aggregate the money paid out to employees under a single pay-roll heading and to do the same for supplies and for space and equipment charges is ordinarily simpler than a classification based on functions. But such a classification does not permit an allocation of the indirect expenses to commodities and to customers, nor does it provide an adequate basis for measuring efficiency and for controlling expenses.

Those natural expenses which cannot be assigned in their entirety to the various functions can be subdivided on the basis of time studies, space measurements, managerial estimates, and so on. The increased cost and effort of preparing functional-cost classifications may be much more than offset by the advantages of improved cost control, as well as by the advantages of cost analysis.

Manufacturers, especially those serving wide markets and selling a number of products, may have complicated distributing organizations and may engage in a wide range of marketing activities. Consequently, it is difficult to set forth a widely representative functional classification of distribution expenses.

For illustrative purposes, however, the following example of a functional classification of distribution expenses for a rubber manufacturer is shown.[1]

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[1] The functions and the primary-expense accounts are based, in part, on those suggested by the Uniform Accounting Manual for the Rubber Manufacturing Industry, which was cited [on p. 741].

FUNCTIONAL CLASSIFICATION OF DISTRIBUTION EXPENSES FOR A RUBBER MANUFACTURER

1. Investment in finished goods:
    - Taxes on stock
    - Insurance on stock
2. Storage of finished goods (portions of following expenses applying to factory, branch, and district warehouses):
    - Rental expense, or
    - Maintenance and repairs to buildings
    - Taxes on buildings
    - Insurance on buildings
    - Depreciation on buildings
    - Heat, light, and power
    - Outside storage space
3. Inventory control, finished goods:
    - Salaries—stock-record clerks
    - Salaries—merchandise distribution (allocation of stock to district and branch warehouses and preparation of orders on factory)
    - Overhead—space, equipment, supplies, and supervision charges
4. Order assembly (physical handling):
    - Salaries—warehouse labor
    - Overhead—space, equipment, supplies, and supervision charges
5. Packing and shipping:
    - Material
    - Labor
    - Overhead
6. Transportation (on merchandise shipped from factory or branch to customer and from branch to branch, and on returned goods):
    - Freight
    - Truck
    - Express
    - Parcel post
    - Transportation on consigned merchandise, factory to branch
7. Sales solicitation (Special commodity or customer subdepartments or subfunctions will be set up according to the operating organization of the company, each with the following primary-expense accounts):
    - Salaries—salesmen
    - Commissions—salesmen
    - Commissions—agents
    - Commissions—brokers
    - Traveling expenses—salesmen
    - Entertainment—salesmen

    Overhead (Except for the second account below, these overhead accounts would not, of course, be set up by commodity or customer subdepartments):
    - Salaries—sales executives
    - Salaries—merchandise-department managers
    - Salaries—district and branch managers
    - Sales employment and personnel
    - Sales training
    - Sales research
    - Sales engineering service
    - Adjustment
    - Sales records
    - Space and equipment charges

8. Advertising:
    - Advertising space:
        - Newspapers
        - Magazines
        - Posters
        - Outdoor signs
        - Electric signs
    - Advertising agency services
    - Art work—outside
    - Radio
    - Displays
    - Motion pictures
    - Electros
    - Overhead:
        - Salaries—advertising managers and assistants
        - Advertising expenses
        - Space and equipment charges
9. Order entry:
    - Salaries—clerical (allocated portion)
    - Overhead—space, equipment, supplies, and supervision charges
10. Credit extension:
    - Salaries—clerical (allocated portion)
    - Overhead—space, equipment, supplies, and supervision charges
11. Billing:
    - Salaries—clerical (allocated portion)
    - Overhead—space, equipment, supplies, and supervision charges
12. Accounts receivable:
    - Salaries—clerical (allocated portion)
    - Overhead—space, equipment, supplies, and supervision charges

Allocation to Products and Customers

After the indirect costs have been classified by functions, they are allocated on the basis of utilization by products and customers of the variable activities giving rise to these costs, just as in the case of wholesaling. The principle followed is to charge the product or customer with the cost of its share of the variable activity of each functional-cost group; that is, the cost of the portion of the variable marketing effort for which it is responsible.

The identification of the variable activity which is involved in each functional-cost group and the broad relationship between the functional costs and the characteristics of products and customers are often evident merely from study. Some functional activities vary according to certain characteristics of the commodity and are not greatly affected by customer characteristics. Others vary primarily according to certain customer characteristics regardless of what product is being purchased.

For example, the variable activity involved in the storage and investment functions depends almost solely on the bulk, weight, perishability, and inventory value of the product stored, and is affected but little by the customer who buys the product. Similarly, the credit function will vary according to the financial integrity and other credit characteristics of customers with little regard to the nature of the commodity on which credit was extended.

As regards still other functional-cost groups, the broad relationship between these costs and product and customer characteristics is more complicated. For there is every shade of combination of customer responsibility and commodity responsibility for the variable activity and, therefore, the amount of expense, within the different functional-cost groups.

Those functional activities which vary entirely with customer characteristics are not allocated to commodities, and, conversely, those related solely to commodity characteristics are not allocated to customers. Some functional-cost groups would usually be allocated to both customers and commodities. And in line with the limiting-factors concept, which was discussed earlier, not all functional costs are allocated to either customers or commodities.

Allocations to customers and commodities were made as distinct, yet parallel, operations in the wholesaling examples given. With most manufacturers, however, these two allocations would be related processes, as will be shown later.

Using the same functional-cost groups that were set up for rubber manufacturers, bases that could be used for allocating costs to products and to customers are illustrated in Table 6. Not all of these cost groups would be allocated in all firms. Each distributor would need to decide which functional activities were limiting factors, and, consequently, which functional-cost groups should be allocated to commodities and customers in view of the particular circumstances in his business.

TABLE 6

BASES OF MANUFACTURER'S ALLOCATION TO COMMODITIES AND CUSTOMERS

Functional-Cost Groups	Bases of Allocation	
	To Commodities	To Customers
1. Investment in finished goods	Average inventory value	(Not allocated)
2. Storage of finished goods....	Floor space occupied	(Not allocated)
3. Inventory control, finished goods....................	Number of invoice lines	(Not allocated)
4. Order assembly (handling)..	Number of standard handling units	Number of invoice lines
5. Packing and shipping.......	Weight or number of shipping units	Weight or number of shipping units
6. Transportation............	Weight or number of shipping units	Weight or number of shipping units
7. Selling....................	Time studies	Number of sales calls
8. Advertising................	Cost of space, etc. of specific product advertising	Cost of space, etc. of specific customer advertising
9. Order entry...............	Number of invoice lines	Number of orders
10. Billing....................	Number of invoice lines	Number of invoice lines
11. Credit extension...........	(Not allocated)	Average amount outstanding
12. Accounts receivable........	(Not allocated)	Number of invoices posted

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Inventory Control. The function of inventory control of finished goods includes the cost of allocating stock to branch and district warehouses and of preparing orders on the factory, as well as the salary and other costs of stock-record clerks. The variable activity giving rise to the expenses of this function conforms most closely to the number of postings made to the perpetual-inventory records, that is, to the number of invoice lines. Consequently, this cost is allocated to products or product lines or departments on the basis of the relative number of invoice lines.

Since the variable activity of inventory control is only remotely, if at all, affected by customer characteristics, in most cases this function would not be allocated to customers. In other words, customers could be added or eliminated —within broad limits, of course—without affecting the aggregate inventory-control expense.

Packing and Shipping. Where possible, this functional-cost group should be assigned direct to each product group. Thus, the amount of shipping material used by each product group can often be determined by direct measurement. Shipping labor also can often be applied specifically to product groups and subgroups, through labor-time tickets. And the overhead or indirect portion of this expense can be allocated on the direct labor-dollar basis.

Where it is not feasible to assign these costs directly, periodic tests should be made of the labor-and-materials cost per ton necessary to ship each product subgroup. The expense of this function can then be prorated to products by multiplying the tonnage of shipments in each product classification by the shipping rate per pound determined through the test. Where weight is not available for any product group, a shipping unit (package, etc.) may be used as a basis for allocating these costs to products.

The shipping rates per pound multiplied by the corresponding tonnage of shipments in each product subgroup to each customer class can be used to allocate these costs to customers. Or, if this is not feasible, an average shipping rate per pound or per unit for all products combined multiplied by the tonnage of shipments to customers would give the packing and shipping costs by customer classes.

Transportation. Where possible, transportation charges should be analyzed from the freight bills and an average rate per ton computed for each product subgroup. Transportation expense can then be assigned direct to products by multiplying the tonnage of shipments in each product classification by this average rate per ton. Where weight is not available for a product group, a unit may be used similar to that set up for allocating packing and shipping expenses to products.

Similarly, where possible, transportation charges should be analyzed from the freight bills and assigned direct to customer classes or to individual customers. If this is not feasible, then the rates per ton for major product groups multiplied by the corresponding tonnages delivered to each customer class—or an average rate per ton for all products combined multiplied by tonnages delivered to customer classes—can be used to allocate transportation costs to customers.

Where the manufacturer makes deliveries by his own trucks, the bases suggested for allocating the wholesaler's delivery costs can be used.

Advertising. Specific product advertising should be assigned directly to major product groups. Further allocation should be made directly to product subgroups or lines or individual items advertised on the basis of the cost of space used for each. Likewise, specific customer advertising should be assigned directly to the particular customer classifications involved. When product subgroups or lines are mentioned in a customer advertisement, allocation should be made to the appropriate products on the basis of the cost of space used for each.

General institutional advertising that cannot be identified with any product or customer class would not be allocated. Other advertising and sales-promotion expenditures, such as advertising overhead and art work, should also be assigned direct or distributed on a job-order basis, where possible. If direct assignment is not feasible, these expenses should be allocated to product and customer classes on the basis of relative appropriations or space and other direct advertising expenditures for each classification of sales. Otherwise, if no relationship can be traced, such items of expense should not be allocated.

Summary of Procedure. There are thus certain data which must be known before the manufacturer's distribution costs by products can be ascertained. These are: (1) the average inventory value of finished goods, (2) the amount of storage space occupied by these finished-goods inventories, (3) the number of times the commodity is sold, i.e., the number of invoice lines, (4) the number of handling units of the product that are sold, (5) the weight or number of shipping units sold, (6) the proportion of sales time spent in promoting it, and (7) the cost of the space or time in the various media that were used in advertising it.

These product characteristics determine the shares of the corresponding functional-cost groups that are allocated to the product. The actual allocation of costs is, in effect, made by simple proportion. For example, if the average inventory value of product group X is $\frac{1}{100}$ of the total average inventory value of all finished products, that group is charged $\frac{1}{100}$ of the investment costs for the period. The sum of the shares of the various functional costs which are allocated plus any direct costs is subtracted from the dollar gross margin of the product, the difference indicating the relative profitability of the product. The results of this procedure are illustrated by the example in Table 7.

This basic procedure is, of course, the same when costing major product groups, subgroups, lines, and individual items or brands. The difference lies mainly in the detail with which merchandise sales and gross margins are classified and functional costs allocated.

The process of customer costing is the same as that of commodity costing. The customer data needed for allocating the functional-cost groups to a customer class or customer are, in the illustration given in Table 6, as follows: (1) the number of invoice lines on all orders for the period, (2) the weight or number of shipping units of the merchandise bought by the customer, (3) the number of sales calls made on the customer, (4) the cost of the space or time in the various media used to advertise to the customer class specifically, (5) the number of orders placed by the customer, (6) the average amount outstanding, and (7) the number of invoices posted to accounts receivable.

TABLE 7

DETERMINATION OF RELATIVE PROFITABILITY OF A CLASS OF PRODUCTS

Functional-Cost Group	Total Functional Cost (1)	Bases of Allocation: Total for Firm (2)	Commodity (3)	Commodity's Share (3 ÷ 4) (percent) (4)	Allocated Costs (4 × 1) (5)
1. Investment	$ 50,000	$500,000	$50,000	10.0	$ 5,000
2. Storage	75,000	400,000 sq. ft.	20,000 sq. ft.	5.0	3,750
3. Inventory control	25,000	$300,000	$ 9,000	3.0	2,500
4. Order assembly	100,000	$500,000	$50,000	10.0	10,000
5. Packing and shipping	60,000	$500,000	$75,000	15.0	9,000
6. Transportation	200,000	600,000 tons	125,000 tons	20.0	40,000
7. Selling	400,000	10,000 hrs.	2,000 hrs.	20.0	80,000
8. Advertising	150,000	....	Direct	....	33,300
9. Order entry	30,000	$400,000	$40,000	10.0	3,000
10. Billing	50,000	$400,000	$40,000	10.0	5,000
Total costs	....	....	....	....	$176,550

Sales	$850,000
Cost of goods sold	632,000
Gross margin	$218,000
Less: Direct plus allocated distribution costs (from table above)	176,550
Excess of gross margin over costs	$ 41,550

These factors are used in allocating to the customer class a share of the functional-cost groups. The total of the shares of the allocated functional-cost groups plus any direct expenses gives the total customer cost. This cost deducted from the total dollar gross margin received from that customer class during the same period indicates the relative profitability of these customers.

RELATED COMMODITY AND CUSTOMER COST ANALYSIS [1]

In the case of the wholesaling examples which were previously described, commodity and customer costing are distinct although parallel processes. Where, in general, all customers purchase all or similar products, this would be the most satisfactory procedure. In the case of most manufacturers, however, such a procedure would not be as satisfactory as one in which commodity and customer cost allocations were related processes. This would be true where sales of a given type of product were made only to a given class of customers. Also, the subsequent allocation to customers of expenses which could first be assigned directly to commodities—and vice versa—would be facilitated where commodity and customer costing were related.

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[1] The method described in this section was adapted from a procedure developed by Wroe Alderson. See *Marketing* by Alexander, Surface, Elder and Alderson (Boston, Ginn, 1944), Chap. 23.

Table 8 shows the procedure by which the commodity and customer allocations are related. The lines on the form represent classes of commodities—again using the rubber manufacturer as an illustration—while the columns represent classes of customers. The squares that result from the cross-classification represent transaction groups, i.e., sales of a specific class of commodities to a specific class of customers.

TABLE 8

PROCEDURE FOR RELATING COMMODITY AND CUSTOMER COST ALLOCATIONS

Commodity Classes	Customer Classes						Commodity Cost Totals
	A Manufacturers	*B* Dealers	*C* Jobbers	*D* Mail Order	*E* Chain Stores	*F, G, H,* etc.	
1. Pneumatic passenger tires and casings......	....	....	....	....	....	....	....
2. Pneumatic truck tires and casings..........	....	....	....	....	....	....	....
3. Tractor tires and casings................	....	....	....	....	....	....	....
4. Solid tires and casings.	....	....	....	....	....	....	....
5. Auto accessories......	....	....	....	....	....	....	....
6. Mechanical rubber goods..............	....	....	....	....	....	....	....
7. Heels and soles.......	....	....	....	....	....	....	....
8. Hard rubber.........	....	....	....	....	....	....	....
9. Footwear...........	....	....	....	....	....	....	....
10. Tiling	....	....	....	....	....	....	....
11. Rubber thread........	....	....	....	....	....	....	....
12. Rubberized fabrics....	....	..	....	....	....	....	....
13. Sundries............	....	....	....	....	....	....	....
Customer cost totals..	....	....	....	....	....	....	(Grand total)

One of these forms would be used for each functional-cost group. If the variable activity of a given function is related most closely to commodity characteristics, the first allocation would be made to commodity classes. In other words, the total amount of the cost group would be distributed as commodity-class subtotals on whatever basis of allocation is used for that cost group, and the amounts entered in the spaces in the column on the right. The next step is to distribute these subtotals to the cells across the form on whatever basis is used to allocate the particular cost to customers.

A similar procedure is used if the cost group is one whose activity varies primarily with customer characteristics. The first allocation would be made to customer classes, which means the total of the functional-cost group is distributed as customer-class subtotals, on whatever basis of allocation is used, and these subtotals entered in the spaces along the bottom of the form. The next step is to distribute these subtotals upward into the cells which represent the classes of commodities purchased by the customers.

As regards expense classifications which can be assigned direct to customers or commodities, the procedure would exactly parallel that outlined above. For example, a manufacturer with specific product selling departments would enter the direct selling costs of these departments in the spaces on the right-hand column and then allocate them across the form to customer classes. Similarly, the direct costs of specific customer selling departments would be entered in the spaces on the bottom line and then they would be allocated and distributed upward to the cells representing commodity classes.

When all of the cost groups have been either assigned direct or allocated on separate forms, a summary form can be used to get the totals. All of the figures appearing in the corresponding cells are added together, the totals being the costs for the individual transaction groups. The next step is to add up the columns and to enter the totals at the bottom, which gives the costs by classes of customers. Similarly, the totals of the amounts on the lines give the costs by classes of commodities.

Finally, the dollar gross margins are entered on the summary form, and the total allocated costs by transaction groups and by customer and commodity classes are subtracted from the corresponding margins. A ranking of product groups and customer classes in the order of the amount of their excess of dollar gross margin over allocated costs discloses the relatively less profitable commodities and customers. Those with the smallest excess of gross margin over costs, and also, of course, those whose allocated costs are greater than the margin, are the relatively unprofitable ones.

ALLOCATION TO UNITS OF SALE

In the main, a cost analysis by unit of sale involves a different classification of sales. Instead of classifying sales by products or customers, the sales, margins, and cost characteristics applying to unit-of-sale groups are determined. The unit of sale refers to one of the following: (1) number of units of product per invoice-line extension, (2) dollar value per invoice-line extension, (3) number of invoice lines per order, and (4) dollar value of the order.

The process of getting costs for the first two unit-of-sale groups, that is, costs by invoice lines, is, in general, similar to the process of commodity costing. Functional classification of expenses and bases of allocation are much the same as those used for product costing. The allocation of costs to sales classified by order-size groups—whether order-size is measured by dollar value or by number of invoice lines—is generally similar to the process of customer costing. Table 9 illustrates the functional classification of costs and the bases used in allocating costs to these two kinds of unit-of-sale groups.

TABLE 9

BASES OF ALLOCATION TO UNIT-OF-SALE GROUPS

Functional-Cost Groups	Bases of Allocation	
	To Sales Classified by Number of Units of Product per Invoice Line	To Sales Classified by Dollar Value of Whole Order
1. Order assembly (handling)...	Number of units or time study	Number of invoice lines
2. Packing and shipping.......	Number of units or time-and-materials study	Weight or number of shipping units
3. Transportation.............	Number of units or time study	Weight or number of shipping units
4. Selling....................	Number of invoice lines or time study	Number of invoice lines or time study
5. Order entry................	Number of invoice lines	Number of orders
6. Billing....................	Number of invoice lines	Number of invoice lines
7. Credit extension...........	(Not allocated)	Number of orders
8. Accounts receivable........	(Not allocated)	Number of orders

In most cases, manufacturers are interested in getting costs by unit-of-sale groups for individual commodities or for commodity classes and for individual customers or for customer classes, rather than for all customers and for all commodities. The effect of unit of sale on cost varies so widely as between products and customers that average relationships have little value. Discount schedules, for example, must be established with reference to single products or customers or to small groups of them.

Forms similar to those used to allocate the functional costs to transaction groups (Table 8) can be used for allocating costs to unit-of-sale groups for each commodity and customer group. In one set of forms the lines may be used for commodity classes while the columns would represent unit-of-sale groups, that is, either the number of units ordered in a single transaction or the dollar value per invoice-line extension.

Similarly, in another set of forms, the columns would be used for customer classes, while the lines would represent either the dollar value of the whole order or the number of invoice lines per order. In both sets there would be a separate form for each functional cost group. On each of these forms, the total functional costs for the various customer or commodity groups, as determined from previous allocations, would first be entered as subtotals and then distributed into the cells representing the various unit-of-sale groups.

The total gross margin for each unit-of-sale classification less its allocated costs indicates its contribution toward the remaining expenses of the business and to net profits. Those unit-of-sale groups with the smallest excess of margin over cost, or those where the cost exceeds the margin, are relatively unprofitable. The cost differentials between the different unit-of-sale groups also provide a basis for establishing or revising quantity and trade discounts.

ALLOCATION TO TERRITORIES

Manufacturers, as well as wholesalers, are also interested in analyzing distribution costs of sales by territories. In many respects, costs by territories are the simplest ones to analyze. If the manufacturer's marketing activities are organized on a territorial basis, with the geographic limits of branches and districts clearly defined, a sufficiently detailed break-down of the primary-expense accounts and their classification by branches and districts results in a direct assignment of a large proportion of expenses to these territorial units.

The costs for individual salesmen's territories can be satisfactorily determined for many purposes by adding up the costs allocated to customers within the territory. This can only be done, of course, if these territories are also distinct geographic units. In other words, the sales, margins, and costs by territories can be ascertained by summarizing the corresponding figures for the customers who constitute the area. Thus, if all the customers in an area are profitable, the area itself must be profitable, and vice versa.

In some cases, however, it may be more satisfactory to allocate or assign directly to the territory certain branch and district expenses which are incurred jointly for several salesmen's territories. But even in such instances, there are some functional costs, difficult to allocate to commodities or customers or units of sale, which can be assigned directly to the sales territory.

The best example of the latter situation is the salesman's salary, commissions, and traveling expenses. If the salesman devotes all of his time to one territory, these, of course, are direct expenses. On the other hand, if he specializes by products or customers and divides his time between several territories, his expenses are indirect and must be allocated to territories. This is done either on a basis similar to that used in allocating selling expenses to customers or on the basis of a time study.

Other indirect selling expenses, such as salaries of district and branch managers, would also be allocated to individual sales territories. This is done by dividing the total indirect selling expense at a branch or district by the number of salesmen in that branch or district and assigning an equal share to each salesman. Or, an estimate of the indirect cost per salesman could be made by the sales managers on the basis of the relative time and effort devoted by them to each salesman.

Transportation and packing and shipping can be assigned directly to individual sales territories, if the primary-expense accounts are kept in sufficient detail. The remaining functional-cost groups are, in general, allocated to individual territories on much the same bases that are used in allocating them to customers.

Table 10 illustrates the procedure for allocating costs to individual sales territories. The gross margin earned in each territory less its direct and allocated costs indicates its relative profitability. The territories in which the excess of gross margins over costs are the greatest are the most profitable; while those in which the excess is the smallest, or those where the costs exceed the margin, are relatively unprofitable.

TABLE 10

BASES OF ALLOCATION TO INDIVIDUAL SALES TERRITORIES

Functional-Cost Groups	Bases of Allocation
1. Order assembly (handling)	Number of invoice lines
2. Packing and shipping	Weight or number of shipping units
3. Transportation	Direct or weight or number of shipping units or ton-miles
4. Selling:	
Direct selling expenses	Direct
Overhead	Number of salesmen or estimated cost per salesman
5. Advertising	Circulation of media or direct
6. Order entry	Number of orders
7. Billing	Number of invoice lines
8. Credit extension	Average amount outstanding
9. Accounts receivable	Number of invoices posted

UNPROFITABLE SALES

When all of the unprofitable sales segments have been identified, it is usually more difficult for the manufacturer to decide what action he should take to maximize profits than it is for the wholesaler or the retailer, for the following reasons: Generally, a greater number of possible profitable courses of action are open to the manufacturer; the marginal costs and revenues associated with each of these courses are more difficult to ascertain; and the ramifications of any action may be more far-reaching. For example, a decision to eliminate a segment of unprofitable sales will probably affect the utilization of manufacturing capacity and, therefore, may affect the unit manufacturing costs.

THE MANAGEMENT CHALLENGE OF MARKETING COSTS

BY JAMES W. CULLITON

How I wish I knew how much we should be spending for marketing! Such a wish has been uttered or muttered by almost every business executive at some time. Today this wishing on the part of businessmen is of more than passing interest because of three simple facts: (1) By and large the amount of money spent by the economy as a whole for marketing is determined by the cumulative

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Source: *Harvard Business Review*, Vol. XXVI, No. 1 (January, 1948), pp. 74–88. Reprinted by permission.

effect of the decisions of the executives of individual companies. (2) As more and more companies are approaching or have already arrived at the point where their products have to be sold rather than apportioned among waiting customers, establishing the *right* marketing expenditure becomes a major consideration. (3) The business executives who must make these decisions are not satisfied that their decisions are correct.

This administrative problem is a challenge to management not solely because the decisions are related to whether or not the company makes a profit. Rather, the effectiveness with which management meets the problem has a direct bearing upon the country's economic welfare, the public's attitude toward private business administration, and the rapidity of social change. For, so long as the popular answer to the question "Does distribution cost too much?" is a strong "Yes," nothing short of the best decisions about marketing expense are in the interest of either corporate profits, good public relations, or the general welfare. Faced with such public attitudes, business executives can take little solace in *their* belief that no one else could do a better job, or in a counter (but unproven) reply that distribution really costs too little.

Lest any reader misinterpret one phase of this article, it is important to note that the "management challenge" has essentially nothing to do with the question of the merits of private enterprise. The challenge of efficient marketing exists under any social system and must be faced by "managers" within that system. The problems remain whether the managers are private business executives or commissars. Few marketing problems which we now have would be eliminated if the whole challenge were shifted to the shoulders of government managers, and there is every reason to believe that some at least would be intensified. For instance, when little freedom of choice is left to the consumers concerning what, when, and where they will buy, the managers must make those decisions for them.

We have, then, an important problem in business administration because responsible business executives must make marketing decisions while their knowledge of the true nature of the problems, their evidence about the facts, and their tools for judging performance are insufficient to insure that the decisions are the best possible ones. As a matter of fact, the knowledge, evidence, and tools are not even adequate to allow the executives, or any one else, to make a sure distinction between good and bad decisions, let alone pick the best.

Conscious of a long-standing need to know more about marketing costs, and supported in this interest by a growing group of business executives, the Harvard Business School recently asked the author to head a study of manufacturers' marketing costs. It was believed that such a study would supplement the knowledge the School had gained from its continuing studies of the costs and operating results in retail and wholesale activities.[1] One purpose of the study was to publish, if possible, some cost data which would reflect the usual relationships of marketing costs in representative manufacturing business organizations. The real goal, of course, was to contribute to improving decisions by increasing the understanding with which they are made.

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[1] The two most recent studies are: Harvard Business School, Bureau of Business Research, Bulletin No. 126, *Operating Results of Department and Specialty Stores in 1946*, by Malcolm P. McNair; Harvard Business School, Bureau of Business Research, Bulletin No. 127, *Expenses and Profits of Limited Price Variety Stores in 1946: Chains and Independents*, by E. A. Burnham.

The research which we have carried on thus far indicates that the publication of common figures will not be practical in the near future because of the difficulty of getting figures which are both statistically reliable and, from a business point of view, realistic. However, our visits to manufacturing companies, our field research, and our observations of the facts of business life do suggest certain basic considerations upon which progress toward the ultimate goal can be made. Some of the tentative thoughts provoked by the preliminary research are reported here.

NEED FOR STANDARDS

In order to avoid quibbling discussions of whether the costs of marketing (or distribution [1]) are too high, it is necessary to define the point of view from which costs are being observed. In this article costs are to be judged not by themselves alone but in relation to the value received in return. There is no point in doing otherwise. For instance, you do not say that $50 per month for rent of an IBM machine is too high until you look at what is being rented (the speed at which the machine works, the number of hours of hand labor it replaces, and so on); or you do not say that $5,000 for a grinder is too high until you know more about its performance.

Now, by and large, businessmen admit that they are not satisfied with their knowledge about marketing costs, and they *feel* that their over-all marketing performance can and must be improved. (Incidentally, the public agrees with them.) Further, it is simply unreasonable to suppose that the cost-value relationship is as good as it would be if more accurate knowledge were available. In other words, marketing costs in any business almost certainly are too high in the sense that they are not "right."

Such a conclusion, let it be emphasized, has nothing to do directly with the question of whether the *total amount* now spent for marketing is too high. There simply is no reliable evidence to prove that business as a whole should spend less on marketing. At best there is an indication—perhaps a strong indication but only an indication—that there is room for improvement in the efficiency of marketing performance, that is, in the value received per dollar spent. But even on this score quantitative judgment is impossible, since standards for measuring marketing performance are not now in existence.

In carrying this thought further, let us take the point of view of the individual executive. One of his main jobs is to control costs. Most of the marketing costs which a business incurs are not for "things" of value, like an IBM machine or a grinder, but rather for services like transportation, advertising, and the like. Value received to a marketing executive, therefore, is measured in terms of results: Do customers really buy what he has to offer, and are the goods delivered to the customers as efficiently as possible? Thus to him a marketing cost is high if (1) more than the correct amount is spent (for, even though the correct results may be attained in the process, some of the money has been wasted); (2) less than the correct amount is spent (this of necessity means that the correct results have not been attained, and thus again the money has been used inefficiently); (3) the correct amount is spent, but because of inefficiency less than the correct results are attained. Conversely, costs are not too high *only* when the correct amount is spent *and* the correct results are attained.

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[1] The National Association of Marketing Teachers suggests that the terms "distribution" and "marketing" be regarded and used as synonymous and further recommends that the use of the word "distribution" be discontinued, in so far as possible. "Distribution" seems to look primarily upon the over-all "creation of time, place, and possession utility" with emphasis on the physical movement and handling of goods. "Marketing," on the other hand, tends to emphasize the selling problems of individual enterprises and looks very definitely at the creation of a sale and stirring up of new wants as well as the delivery of goods to fulfill existing wants.

Obviously for an executive in any given situation to be certain that costs are not too high he would have to know not only (1) what amounts *were* spent and (2) what results *were* attained but also (3) what amounts *ought* to have been spent and (4) what results *ought* to have been attained. Our research observations show that especially with respect to marketing the business executive ordinarily does not know any of these four facts with any degree of accuracy.

It is generally known that automobile engines are on the average only 30% efficient. In order to determine such a rate of efficiency automotive engineers had to know both actual performance and 100% performance. The measure of efficiency of a heat engine is based upon the function of such an engine, namely, to change heat energy into mechanical energy. Quite exact measurements of both heat energy and mechanical energy are possible because there exist not only widely accepted definitions of both but also techniques for measuring them. It is because the definition and measurement of marketing costs and functions have not advanced nearly so far as the definition and measurement of physical phenomena that no one is able, with the same degree of assurance, to make quantitative statements about marketing efficiency. In short, there simply are no reliable and accepted standards of performance in marketing.

NORMS OF JUDGMENT NOW USED

In spite of all these difficulties, the business executive cannot sidestep the necessity of making marketing decisions; he must design some sort of "marketing machine." Like everyone else he must "have something to go by," however tenuous it may be. Therefore, in the absence of measurable standards he sets up what might be called "norms of judgment" to use as guides. These norms are used to different degrees in different situations; they are supported more or less with figure and other factual evidence from one time to another and from one company to another; they are used not separately but as an integrated whole; and the importance of any one is determined by the accident of current circumstances and by the training and habits of the executive. According to our observations the businessman faced with the task of deciding how much to spend for marketing has five main "norms":

The Dynamic Status Quo

If a company spent $50,000 on marketing last year, and if the net results of the company's operations, profitwise, were satisfactory, the first approximation of an expenditure for this year will be $50,000. In other words, "if results are satisfactory, do not disturb the status quo" or "the devil you know is better than the devil you don't know."

However, all the factors affecting a business do not remain constant from one year to another. For this reason the executive does not accept the status quo without some adjustments; he exercises judgment upon the basis of his appraisal of the importance of other changes and makes the status quo dynamic. For example, he might say to himself: "I expect general business conditions to be better; therefore I will exert more effort in marketing and make a better showing," or, alternatively, "therefore I will spend less on marketing because sales will be easier to make." He might say: "We have improved our product so that the product is more attractive and will require less selling," or, alternatively, "but the public must be educated to appreciate it, so we will spend more on promotion," or even, "sales volume will be up substantially so our costs of handling orders and delivery will naturally be higher in total." And so on. The dynamic factors are almost innumerable, and yet last year's actual figure remains as the benchmark or starting point.

Increment Costs versus Increment Revenue

Some executives look upon most of their marketing costs as distinctly under their control; in other words, management can decide to eliminate certain costs if it chooses to do so. Advertising appropriations, for instance, fall in this category. One executive put it this way: "Before the war we were spending $4,000 for advertising; now (1947) we are spending at the rate of $60,000. The $60,000 must produce $750,000 worth of business which we would not otherwise get if it is to pay for itself at our normal profit rate of 8% on sales."

This line of reasoning is based on the theory that extra expenditures are worth while only if they produce extra revenues at least sufficient to pay for themselves. The big difficulty with this approach is, of course, the impossibility of measuring whether the expenditure does actually produce revenue which would not otherwise have come to the company. Does $60,000 worth of advertising produce more sales than $50,000 worth? Who knows? No one has developed laboratory experiments to find the answer; and once $60,000 has actually been spent, no one can reconstruct what would have happened if $50,000 had been spent instead.

This discussion also begs one of the most important questions, namely, whether the money is actually well spent. No doubt an extra $10,000 spent on bad advertising will not add materially to the sales produced by $50,000 spent on bad advertising. Thus, the lack of real qualitative measurements of selling effort, when added to the difficulty of relating sales results to sales expenditures, doubly complicates the problem.

What Competitors Are Doing

Businessmen have a remarkable proficiency for finding out or guessing with reasonable accuracy what their competitors are doing. If the executives of one company observe that another company in the same line of business is aggressively soliciting business, they will feel that they must follow along. There are two interwoven reasons for such a procedure:

1. The first is a defensive mechanism: "If we don't follow suit, we will lose out." Carried perhaps to the ultimate, this can lead to higher and higher appropriations for marketing by every member of the industry until the results in the industry as a whole will not meet the increment costs versus increment revenue test. The critics of current marketing expenses delight in citing such cases; they frequently refer to the cigarette industry as being in such a condition. To the management of any one cigarette company, however, there is strong possibility that the increment test justifies its expenditures, because without those expenditures sales would be lost.
2. The second reason borders somewhat on "keeping up with the Joneses," although frequently it may have a definite tinge of mental laziness. If a strong, well-managed, and successful company follows a certain program, the executives of weaker and less aggressive companies may suspect that there must be sound reasons for that program, and therefore they follow suit.

Circumstantial Pressures

Frequently, complicated patterns of external and internal events produce a set of circumstances that severely limit the freedom of choice of a business executive. One company in a very precarious cash position refrained from adding additional salesmen even though a sound marketing analysis suggested that such a move would have been worth while and profitable. Others are prevented by law from incurring certain expenditure patterns; cosmetic manufacturers, for instance, may not use demonstrators in just the way their appraisal of markets would dictate.

Then again, personal preferences of executives may bias decisions one way or the other; everyone has heard of companies which are referred to as "sales-minded," or "production-minded," or "research-minded." Such biases may not literally be called "norms." Yet, realistically they do affect the decisions that are made and also tend to shape the complicated pattern of circumstances that becomes reality.

The Professional Artist's Trained Ear

President Lowell's oft-repeated statement that business is the oldest of the arts and the newest of the professions may to some sound trite. Yet, when applied to individual business executives, it takes on new meaning. A business organization is every bit as complex as a symphony. One conductor may call for emphatic brass and another for predominant strings, in interpreting an identical passage. The music of the two conductors may differ considerably and yet be pleasing in equal degree, although perhaps to two incompatible groups of listeners. So it is with business: one organization emphasizes advertising, another product design, another low-cost production; and each of them ends up with an "equally pleasing" profit picture or finds a sufficiently large audience for its particular symphony to justify its existence.

The professional musician, through training and practice, may call upon an infinite variety of tones and shadings to achieve a desired result. The business executive, like the most proficient pianist, practices long hours, tries variations in treatment, and augments his own natural talent through persistent attention to its best use. In some way, as yet only partially understood, he develops a "feel" for the best way to combine all possible factors in order to attain pleasing results.

Because the real business executive is therefore a "professional" artist, all of the first four norms are used with the artist's sense of balance. The finished piece must have melody, rhythm, and harmony, but one time rhythm predominates and another time melody. And who is the critic to say that the executive's choice is wrong? A critic may say that he does not *like* the performance, but he cannot support, in most instances at least, the statement that it was bad.

IMPROVEMENTS IN THE SYMPHONY

We have seen, then, that in lieu of standards business executives are forced to use much more artistic norms of judgment in making their decisions. This does not mean, however, that these business executives are satisfied; nor is the general public. Everyone would like improvements.

The keynote of the problem lies in the desire for *improvements*. There should be no attempt to find immediately *the final answer*, for such an effort would be doomed to failure. On the other hand, there is every reason to expect that better performance could be achieved, and one way of doing it would be through greater knowledge. The nature of the problem suggests that a restatement of some basic truths—some of the facts of business life—should clear the air and perhaps suggest leads to follow. Because such basic truths are things which business executives see every day and at least subconsciously are fully aware of, itemizing them may seem childish and unimportant. Yet the history of progress clearly indicates that the commonplace frequently holds unsuspected secrets. So let us look at a few of the facts of business life which business executives might well reconsider as they strive to improve the marketing symphony.

FACT NO. 1: THE ESTABLISHMENT OF STANDARDS DEPENDS UPON STANDARDIZATION

Standardization of functions has not progressed so far in marketing as in production. Standardization, it should be noted, is one of the foundation stones upon which cost control and cost reduction (relative to results attained) have been accomplished in production. To one who has not seen it done, it is almost uncanny to watch the accuracy with which an engineer can synthesize a production program. Through years of experience with standard ways of doing small tasks engineers have developed many standards of performance which can be grouped at will to make different combinations. Thus, a company making steam shovels and a company making typewriters can both be guided by the same standards of performance if they are faced with the task of removing 0.001″ from the surface of a brass casting; the tensile strength of a given alloy remains the same in the construction of a bridge or an airplane. Not so with marketing; often a given problem may be solved by diametrically opposed approaches with apparently equal success.

When we review the early efforts of Taylor to improve production methods and lower costs, we rediscover that he did not start with factory superintendents; rather he observed laborers shoveling. He took innumerable observations of the man, the shovel, the material shoveled, work habits, and countless other variables. After a long, long time he arrived at an optimum shoveling load for the "average laborer" and varied the size of the shovel with the mass of the material shoveled. He used a bigger shovel for feathers than for stone.

And so goes the story of "standardization" in production: it was not big, complicated operations which were standardized but rather small parts which could be joined together in different ways for different purposes. Frequently the joining together of standardized production operations is still an artist's job; witness the variations in the design of the competing automobiles.

We might expect, therefore, real improvements in marketing to come from unobtrusive work on details, like Taylor's observations of men shoveling. Thus those studies which are carried on to find a better way to select personnel for selling jobs, to improve the layout of a shipping room, to get the best lighting in a salesroom, to improve and find the standard elements in any marketing job are laying foundations for greater progress.

FACT NO. 2: COST FIGURES ARE LIKE PHOTOGRAPHS

If several publications like the *New York Daily News*, the *New York Times*, and *Life* sent out photographers to get pictures of a news-worthy story, it would be most unlikely that each would come back with the same or even similar pictures. One would probably hire an airplane for an air view, another would take a straight picture, another would try to get a trick shot, and so on, for as many photographers as were sent out.

So it is with business figures: Business is full of events of which various people would like to have a "picture"—the shop foreman, the plant superintendent, the sales manager, the cost accountant, the treasurer, the president, the tax collector, the stockholder, the banker, and so on. The picture each one of these would most like depends upon his needs and wants just as much as the picture which would satisfy an editor depends upon the publication's policies and accepted audience. To cite only one example, in the course of this research the author visited a company which had four distinct over-all•figure pictures—one for financial management, one for pricing, one for cost control, and one for tax purposes—and the variations of smaller pictures within each of the big ones were almost innumerable.

Rather than being surprised to find that business figures vary so, one should expect such variation. Yet much misunderstanding among managements, among critics of management, and between management and labor flows out of an unwillingness to accept the facts of business life. Today, as the challenge for lowering marketing costs looms larger, there is a strong move to obtain more pictures of the marketing cost structure so that marketing executives will have more facts with which to work. A review of some of the "angles" from which cost pictures can be taken is very much in order if the "more facts with which to work" are going to be used to best advantage.

a. Unit versus Enterprise Costs. Only a few types of business costs are incurred on a basis of the unit of product. It is rare if more than materials, some labor, and certain packaging, handling, and delivery costs can be related directly to units. On the other hand, a great group of business costs are incurred by the enterprise as a whole for the purpose of being in business. Thus a company of any reasonable size needs a president, a sales manager, a credit manager, and so on, who work not "on units of product" but rather "for the company." You get one set of "figure-pictures" if you look only at real unit costs; another if you look at "enterprise costs"; and still another if, by the trick photography of assumptions, you try to make believe that all costs are unit costs.

b. Fixed versus Variable Costs. The business facts referred to in connection with unit versus enterprise costs give rise to fixed and variable cost relationships. Business management in its job of keeping costs under control can synchronize almost perfectly one set of costs, the unit costs, with changes in volume of sales. In some business situations the adjustment is almost automatic; in others it requires prompt and forceful management attention. Thus those costs which can be adjusted quite promptly to changes in revenue caused by changes in volume are called "variable." On the other hand, those enterprise costs which have little automatic and direct relationship to volume can be changed only by slow and painstaking adjustments in the character of the enterprise through farseeing management planning and action.

It should be noted carefully that the classification of costs as "fixed" or "variable" is a changing task. In the early days of the development of factory systems of production, "direct labor" was an out-and-out variable cost. It was not unusual for a mill owner, for instance, to send his entire work force home in the middle of a work day when "there was no work to do." It was considered part of his property rights for him to be able to do so. Evolution of social pressures has now, however, made it impossible for business management to adjust direct labor costs so promptly to changes in volume. Thus, as more and more costs shift from the purely variable to the partially and slowly variable, and even to the fixed, management's job of controlling costs requires new tools and new ideas.

The chief postwar problem of one of the companies the author visited lay precisely in this area. Because of constant attention, direct production costs had been kept under control as volume declined. Postwar unit production costs were, as a matter of fact, somewhat below the prewar level. Yet, as the volume of business declined from swollen war peaks, the "enterprise costs" (including many selling costs) did not come down quickly or easily. Management's action in the light of this situation was a critical review of those costs and a drive to reduce them.

c. Rate of Expenditure versus Average Costs. You get another picture of a business when you look at costs from this angle. If you are planning a 60-mile trip in your automobile, you know in advance that you must complete the trip in two hours if you are to average 30 miles per hour. You also know from experience that you probably will have to drive at 50 miles per hour some of the time in order to average 30 m.p.h. And after the trip is over you can calculate that if the trip actually took two hours and fifteen minutes, your actual average speed was 26⅔ m.p.h. You may have driven at this average rate only seldom; in all probability most of the time you were driving 50 m.p.h., standing still as you waited for traffic, going through cities at 18 m.p.h., or accelerating and decelerating from one extreme to the other.

So it is with business cost-figure pictures: After a business period has been completed, a figure expert can tell you that costs "on the average" were 26⅔ cents per unit (e.g., selling costs, which obviously vary from one kind or size of customer to another); but there is no irrefutable truth to the statement that each unit cost 26⅔ cents. It would be just as reasonable to say that some units "cost" 50 cents and others cost but 18 cents, although the figure-techniques of business are not nearly so well equipped to measure such facts as the speedometer on your car to measure the rate of speed at any one time.

Consequently, unit cost figures during any business period can be no more than estimates of what the current rate is or of what the final average will be, and unit cost figures after the close of a business period can be no more than averages. Many marketing cost figures which are reported to business management are of necessity averages based upon many, many assumptions. To be of real help in meeting the challenge they must be used with care.

d. Service versus "Bread-upon-the-Water" Costs. Just as there are many production costs, such as material and direct labor, which can be closely identified with units of product, so also there are certain marketing services which are related to unit of product. These include, for example, transportation and delivery, packaging, and certain other services such as credit, servicing of products, and return privileges. Measurement of these "service" costs in dollars is not always easy because, while they are related to units of product, they are not all necessarily incurred by each unit of product. Essentially they relate closely to actual service rendered to actual customers.

Quite distinct from the service costs is another group of marketing costs which are the particular concern of business executives and critics of business alike; these constitute the "bread-upon-the-water" costs that are incurred in the hope of inducing someone to become a customer. One company calls these order-getting costs as distinct from order-filling costs. Order-getting costs can be looked upon in many ways: (1) as the company's own money which it must spend to secure customers; (2) as money that must be included in the sales dollars that the customers give to the company in order to cover its cost of "calling upon" a large number of noncustomers; (3) as pure waste; (4) as good business; (5) as a necessary evil; (6) as a distinct social service.

Whatever the emotional way in which such costs may be regarded, the fact remains that business, as we know it, does incur such costs; and that business units which refuse to do so usually fail to remain in existence very long. It should be observed that this ties in directly with the fact, already alluded to, that under our current social organization business executives must make a large number of decisions about such costs and that by their own admission they know precious little about the real nature of the problem.

Another important observation must be made in this connection. Many of the costs which critics claim are high are incurred because of an insistence by the purchasers on exercising a freedom of choice concerning what, when, and where they will buy. If freedom were removed from buying, many costs could be eliminated. Here, as in political freedom, freedom is not free; it must be paid for. This is not the place to discuss whether the price is worth the result, and in any event we all admit that the price should not be *unnecessarily* high because of inefficiencies. Yet there is convincing evidence that the American people are willing to pay quite high legitimate costs for freedom.

I strongly believe, too, that freedom of choice in buying is one of the most important foundation stones of all freedoms and that if this were removed, even for the purpose of lowering marketing costs, other cherished freedoms would also be doomed for an early death. An omniscient authority that in order to reduce marketing costs tells men when and where they shall buy their shoes, how much they shall pay, and what color the shoes shall be will soon tell them where to go to church. Because of the nature of business costs, therefore, it may be dangerous to set efficiency as a goal to be too blindly sought or too narrowly defined. The business of marketing is an integral part of a social as well as an economic organism.

Fact No. 3: Reporting Business Facts Is an Art

Many of the items mentioned above (for instance, bread-upon-the-water costs and fixed and variable costs) are easy enough to talk about, that is, to recognize. Their existence is part of the nature of business. Yet to put dollar signs on figures which measure the size of those costs is quite another story. The difficulty of translating enterprise costs into unit costs has already been mentioned. The problem of separating costs when they are jointly incurred for several functions, and of separating results which jointly stem from one cost, is even worse. If a salesman engaged in order-getting also carries products in his car and delivers them when a sale is made, the problem of separating the order-getting costs from the order-filling costs is well nigh insoluble.

At this point the artistry of a professional executive once again enters the picture. Although figures which are the one-and-only *right* cost figures can never be accurately arrived at, some reasonable approximations can be made which will enable the experienced artist-manager to make a reasonable decision. But it is very unreal to say that such figures are a clear, truthful, and realistic picture of the actual situation. To anyone but the artist for whom they were prepared (and such artists are frequently temperamental) such figures are as likely to misrepresent the facts as not.

Of course, there are some who believe that if only we spent enough time, money, and brain energy on the measurement problems of business, we could arrive at the correct cost figure for units of product, for types of management activities such as marketing, and for other significant bases of judgment. This reasoning runs along the lines of the following analogy: Few speedometers on cars are strictly accurate in measuring rates of speed. For their test cars, however, motor car manufacturers have developed speedometers which are considerably more accurate, and there are electronic devices that can eliminate almost all errors. The only reason that extra-accurate devices for measuring rate of speed at any given time are not included on an everyday car is because they are too expensive in view of the fact that a driver does not need to know that information as accurately as do design engineers. Similarly in business, it is argued, given sufficient need to justify the expense, more accurate measuring techniques could be developed.

But I do not agree that this analogy applies to business. I believe the facts of business life are such that even in theory, and quite apart from the poorness of our measuring tools or the expensiveness of developing more accurate ones, there just is no such thing as a real unit cost, a real marketing cost, or a real cost of anything else; and so long as technicians act as if they are trying to get *the one* true cost for anything, they are misleading themselves and all who use their figures.

This does not invalidate the use of figures; nor does it argue against continuing to collect them or continuing to try to improve measurement techniques. On the contrary, it urges increased experimentation for improved techniques *but* within what I believe to be the only framework which is compatible with observed facts; namely, that the number of "true" cost pictures which can be taken of a given business fact is almost infinite; that human beings, when faced with such a situation, have to "idealize" it by making certain assumptions and saying, "Let's look at the picture as it would be *if* all the enterprise costs were equally distributed among the units," while recognizing at the same time that this is not a fact. Then, even though it is not a fact, the picture proves useful in helping an executive make judgments about the whole situation.

Note, too, that immediately thereafter the executive using such figures as a basis for judgments may say with equal faithfulness to the facts: "Let's look at the picture as it would be *if* the first unit absorbed all the enterprise costs," or "*if* the president's salary is charged one-half to sales and one-half to production," or "*if* we allocate telephone expense on the basis of floor space." And none of these pictures, again, is *the* true picture; no *one* could be. Yet each such picture, or group of pictures, does tell intelligent management something about business realities. Once again it is perfectly obvious that the trained, "professional" artist who instinctively sees more in a picture than do amateurs, who instinctively compares the "pleasing effect" of various combinations, can go on to heights of accomplishment that would be impossible were there just one cold actual reality. The growing stylishness of distribution cost accounting gives marketing executives an opportunity to use new tools and at the same time a responsibility to use them discreetly.

FACT NO. 4: ALL BUSINESS IS FUTURE

Frequently business reporting is looked upon principally as the job of capturing a picture of what has happened in the past. But in a real sense business executives are interested in what has passed only to the extent that it helps them in their main job—making decisions about the future. Just as frequently the "reporter" is called upon to make what the architects call "An Artist's Conception of the Proposed ——." Almost always there will be several such "proposed" possibilities, and each will be idealized to emphasize the main points of consideration. Just as an architect feels justified in leaving unsightly (but real) telephone poles out of a sketch of a proposal, so also business executives can eliminate certain bothersome but relatively unimportant facts from their studies of the future. Pictures under such circumstances will be based upon facts, but those facts may be "idealized" to suit a particular purpose. The real moral is: All business is future, and it is this fact of business life, not figure theory, that controls the composition of the most useful business reports.

For this reason the marketing executive, who probably knows better than anyone else that all business is future, must be alert to the differences between the job yet to be done and the report of the job just past.

FACT NO. 5: SALES EXPENSE IS NOT THE SOLE CAUSE OF A BUSINESS'S SALES

Physicists refer to the "resolution of forces" when several different forces are exerted on a given body. No one force can explain the movement of the body; rather the characteristic of the body itself, plus the net effect of all the forces, determines the final result. Although one would expect a similar resolution of forces in such a complex area as marketing, many of the analyses of sales expense seem to indicate, by implication to be sure, that sales expense is the sole causal factor producing the net sales of a business. Many businessmen and especially the figure-workers in business talk as if they believed this. They express sales expense as a percentage of net sales, implying a causal relationship between the two.

Yet the figures we have examined in our research to date indicate that quite probably there is, in general, a stronger correlation between general business conditions and the sales of most companies than between the amount spent on bread-upon-the-water costs in any given year and sales. One research director of a large company found that the facts in his company forced him to ask the company's executives the very basic question of policy: "Do you want selling expenses to be stable in total or stable as a per cent of sales?" because, as he told them, "you can't have both!"

There is much evidence, too, from our observations to indicate that those costs which are usually called "selling expense" do not constitute the only, or at times even the major, bread-upon-the-water costs. In one business, for instance, research and experimental costs seemed to be the most important order-getting costs; in another, the constant lowering of production costs to reduce price was important; in another, the service rendered; in another, the credit offered. It is interesting to note, for instance, that new and struggling companies frequently use less stringent credit terms than older established companies as a device to get sales they otherwise would miss.

In businesses where no one company has any outstanding competitive advantage, the mere existence of the business tends to produce sales. The total available business tends to split rather equally among existing firms, merely because they all render "about the same service." Bread-upon-the-water costs, under such circumstances, are spent largely to influence small portions of customers to change from one competitor to another. (Incidentally, this phenomenon explains to a large extent the prevalence of reciprocity in industries like paint and oil.) In other words, it is probably true that much of the sales expense of a company may be applicable only to a marginal fraction of its sales volume.

It should be recognized, too, that sales volume is related not only to the money spent currently to maintain a given "sales capacity," but also to the money previously "invested" in order to attain it. This is clearly illustrated by the case of a company which had failed to make such a previous investment. Having "coasted" on easy-to-get business during the war, the company entered the postwar period with very little real sales capacity. As a consequence it suddenly had to establish its sales capacity by making an outright expenditure of $50,000—a large amount for a small company to spend in one lump sum—for the purpose of building up new catalogues, new mailing lists, and a new agency organization.

This is one area of business where accepted accounting practice does not match the facts of life. When a company builds and equips a factory, the expenditure is "capitalized" as an asset, but when a company invests money in building its sales capacity, those expenditures are charged to "expense." The company just referred to went along for almost a year reporting substantial operating losses on this account. Of course accepted accounting practice may have sound reasons for its decision in such cases; the usual method is conservative, and the measurement of what sales expenditures are expenses and what are "investment" is, figurewise, an impossible task anyway. Nevertheless business executives in many business situations (and also their critics) cannot accept such accounting figures if they are to have sound evidence for judgment or decision.

As a matter of fact, although businessmen often *talk* as if they believed the figure-workers' oversimplification that current sales expense is the only cause of sales, they certainly do not always *act* that way. The "dynamic status quo" norm, for instance, positively works on a different premise.

STEPS IN THE RIGHT DIRECTION

At this point in our observations, the possibility of lowering marketing costs (in the fundamental sense of matching the right expenditure with the right results) might look pretty dark: We have a complicated system of interrelated cause and effect. We have artists playing largely by ear because they have no reliable standards. Even assuming theoretical standards, we have no measuring devices capable of measuring how the actual performance compares with 100%. We have critics who cannot prove that the artists' performances are bad because they too lack standards and can at best only report that they and certain other people *feel* that a specific performance is not so good as it ought to be. Where do we go from here? There are at least three promising avenues of attack and therefore three rays of hope.

Step-by-Step Advance

Taking a cue from production management we might well emulate the early pioneers in that field and try to standardize certain insignificant parts of the marketing job, just as Taylor started with shoveling. This suggestion, obviously, is neither new nor startling; it may, however, have greater appeal in the light of the background sketched in here. The order-filling operations are not too difficult to study in this way, and many concerns, such as the large mail-order houses, have made remarkable progress along these lines. The continuing study of all phases of marketing, such as buying motives, channels of distribution, the effectiveness of varying kinds and amounts of advertising, shifting of the performance of certain functions from one group to another, all fall within this area.

The principal pitfall is to expect too much. Each improvement is worth while, and eventually perhaps some standardization or grouping of small standard parts may become feasible. Thus all the students of marketing and all the executives who are dissatisfied with what they now have to work with and who are seeking better tools actually are engaged in lowering marketing costs. From our observations they are more successful than is commonly supposed.

Internal Standards

Scientists of all kinds are dependent upon controlled experiments for observing phenomena and relating causes and effects. "Other things being equal" is a by-word of scientific observation. One of the greatest difficulties encountered by students of business is that other things are never equal when they are observing several different business situations, and except in small areas "controlled experiments" have not yet been devised. One of the most common remarks of business executives is "Our business is different." The remark is even truer concerning a business's marketing problems than its production problems because in the latter standardization has progressed so much further.

There is, however, a real opportunity for progress along this line *within* individual business organizations—that is, through observing facts as they occur and developing internal standards from the analysis of such recorded experience. Thus it is possible to make comparative studies of performance according to individual salesmen, territories, different advertising media, and a host of other common denominators. In the case of studies made within a given company, at least some of the "other things" tend to remain somewhat equal. And although every realist knows that no two sales territories are alike, so that even in the same company comparing two salesmen's performances is not exact, techniques are being developed to help adjust and equalize the "other things."

Furthermore, there are some situations where, rather than waiting for facts to develop, businessmen can in advance standardize many of the "other things." This constitutes an even closer approach to the scientists' "controlled experiment." Advertising campaigns are frequently tested in this way, and the technique has been used occasionally in other fields of marketing.

These specific approaches deserve the attention of the business executive who would use all possible tools for improving the marketing pattern and meeting the challenge that faces him. They can be useful immediately, and they may also open the door to further developments. But, let me emphasize at the risk of being repetitious, it calls for the delicate touch of the artist, not the surehandedness of the technician.

EXTERNAL STANDARDS

At present external standards seem to offer the least opportunity for aid. When the research from which this article stemmed was first started, there was an implied assumption that a study of manufacturers' marketing costs would result in the publication of some "common figures" or figures which would be useful to several business managements facing similar problems. After years of slow progress such figures were developed for department store operations—although when that research was started over 30 years ago, it faced problems which appeared as insuperable as the ones we are facing now.

"Common figures" must, of course, be common to some group of similar businesses. To date nothing common to the marketing problems or costs of manufacturing businesses has been observed. Industry or product classifications do not suffice because of the realistic practice of business units of not confining their business to watertight product classifications, but rather of taking on those activities which appear to possess profit possibilities which the good of the whole business demands, or which, at times, the whim of the dominating executive dictates.

Other classifications suggest themselves, such as companies which use similar channels of distribution, or those which render similar services to their customers, or those whose management's artistry follows similar lines. The difficulty with these, however, has always been that the distinguishing notes of the various characteristics are too difficult to describe, plus the fact that the figure-picture-taking machinery within the companies has not been set up to take pictures from the angles necessary.

Indeed the only observation which does seem adequately supported by field work is unfortunately a negative one: the figure reports in business organizations today are not so set up that they could truthfully be combined with the figures of any other business. Unfortunately also, at least for the purpose of developing external standards for judging marketing costs, there seems to be no sufficient reason at the moment why any corporation should attempt to rearrange its figures so that such comparisons could be made. The figure techniques and the facts of business life are such that the figures would be extremely unrealistic and unreliable except in the hands of an experienced artist; and, in view of that fact, the compiled results would be of little practical help either to the businessmen who face the challenge or to their critics.

Yet even in the area of external standards there is one possibility for progress already open. External standards need not be only in the form of cost *figures*. If, through the use of controlled experiments for instance, business executives are able to learn more about true causal relationships in the marketing functions of their companies, there is every reason to believe that some *generalizations* common to more than one company will result. To guess now as to what they might be would be to deny the reason for the experiments. There is every evidence, however, to suggest that common standards of performance could be discovered for at least some parts of the marketing job.

WHAT ABOUT MEETING THE CHALLENGE?

As usual, businessmen must act in the face of insufficient evidence. In view of the observations just made, I believe that intensive work upon the development of external figure standards would, for the present at least, be misdirected. Rather businessmen and students alike should expend their major effort on step-by-step standardization of minute parts of the marketing process, use and testing of internal standards of performance, and attempts to make controlled experiments in as many areas as possible. These offer tremendous opportunities for profit and for improvement of the marketing functions. At the same time these activities offer the best means of preparing for the further development of external standards.